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No. 05-

IN THE

Supreme Court of the United States

DARRYL S. LADDIN, AS TRUSTEE OF THE ETS CREDITORS' LITIGATION TRUST,
Petitioner,

v.

RELIANCE TRUST COMPANY, PENSCO, INC. AND COMMUNITY NATIONAL BANK,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the personal, equitable defense of *in pari delicto* is assertable against a bankruptcy trustee who has succeeded to the interests of a debtor pursuant to 11 U.S.C. § 541(a), where the debtor and alleged wrongdoer has been eliminated and any causes of action successfully prosecuted by the trustee will inure solely to the benefit of innocent investors and other creditors of the bankruptcy estate.

2. Whether, in any case or context, the *in pari delicto* defense applies to causes of action arising under the federal Racketeer Influenced and Corrupt Organizations ("RICO") Act, 18 U.S.C. § 1961, *et seq.*

3. Whether, even if assertable against a wrongdoer, the *in pari delicto* defense applies to RICO claims brought by a bankruptcy trustee, given the strong policies of compensation and deterrence embodied in the RICO Act and equitable principles favoring distributions to creditors embodied in the United States Bankruptcy Code, 11 U.S.C. § 101, *et seq.*

PARTIES

The caption of this Petition contains the names of all remaining parties to this action. The original plaintiff in this action was the Official Committee of Unsecured Creditors of PSA, Inc., *et al.* (the "Committee"). The plan of reorganization confirmed in the underlying bankruptcy case, *In re PSA, Inc., et al.*, in the United States Bankruptcy Court for the District of Delaware, Case No. 00-3570 (JCA), subsequently created the ETS Creditors' Litigation Trust (the "Trust"), of which the Petitioner was appointed as Trustee. All interests in any claims or causes of action held by the bankruptcy estate were thus transferred from the Committee to the Trust, and Petitioner was substituted for the Committee as the plaintiff in this action. The case was also transferred from the Bankruptcy Court to the United States District Court for the Northern District of Georgia, Atlanta Division. All Defendants in the case other than the Respondents entered into settlements with the Petitioner while the case was pending in the courts below, and therefore are no longer parties to these proceedings.

CORPORATE DISCLOSURE STATEMENT

The Petitioner does not have any parent corporation or stockholders, and therefore has nothing to disclose pursuant to Supreme Court Rule 29.6.

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ETS CREDITORS' LITIGATION TRUST,
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**Petition for Writ of Certiorari to the
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PETITION FOR WRIT OF CERTIORARI

Darryl S. Laddin, as Trustee of the ETS Creditors' Litigation Trust, respectfully petitions This Honorable Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Georgia granting the Respondents' motion to dismiss (attached as Appendix A hereto) is not reported. The opinion of the United States Court of Appeals for the Eleventh Circuit affirming the District Court's dismissal of claims against the Respondents (attached as Appendix B hereto) is reported at 437 F.3d 1145 (11th Cir. 2006).

JURISDICTION

The order of the Eleventh Circuit at issue in this Petition was entered on January 30, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 541(a) of the United States Bankruptcy Code, 11 U.S.C. § 541(a), provides, in pertinent part:

> The commencement of a case under . . . this title creates an estate. Such estate is comprised of . . . all legal and equitable interests of the debtor in property as of the commencement of the case.

STATEMENT OF THE CASE

The facts relevant to this appeal are not complicated.[1] In 1994, Charles Edwards formed ETS Payphones, Inc. ("ETS"), with the initial intent of purchasing a small number of payphones to operate himself. Unfortunately, however, he shortly conceived of an ill-fated business plan for ETS that ultimately deteriorated into a classic Ponzi scheme. Touted under the slogan "Opportunity doesn't always knock . . . sometimes it rings," the scheme ultimately bilked thousands of investors—many elderly or retired—out of hundreds of millions of dollars, and left ETS with an insurmountable $400 million in debt and doomed to bankruptcy. As correctly observed by Justice O'Connor in reference to Edwards's catch phrase "opportunity rings," for the 10,000 people who invested a total of $300 million in the scheme, "sometimes it hangs up."[2]

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[1] Because this appeal stems from successful motions to dismiss, the Court must accept as true the allegations in the Petitioner's complaint. *See, e.g., SEC v. Edwards*, 540 U.S. 389, 391 (2004).

[2] *Edwards*, 540 U.S. at 391.

The essence of the ETS business plan involved the sale of payphones to the public as a vehicle for investment. Each payphone was offered for sale with an agreement that the purchaser lease it back to ETS for a fixed monthly payment, giving the purchaser a guaranteed annual return of 14 or 15 percent on his investment. Remarkably, ETS guaranteed this return regardless of the location or actual income of the payphone.[3] Not surprisingly, thousands of investors bought the pitch. Indeed, it appeared to be a no-lose proposition. Predictably, however, since the rate of return guaranteed by ETS had no basis in the revenue actually generated by the payphones, and the entire plan ignored the advent of cell phones, the payphones eventually failed to generate sufficient revenue for ETS to make the monthly payments required by the leaseback agreements. As a result, in classic Ponzi fashion, ETS inevitably began to depend on funds from new investors to meet its obligations to prior investors. The ever-deepening insolvency of the company, however, was ignored. Instead, Edwards engaged ETS in financial deceptions to cover up the scheme and stepped up the influx of new investors by selling thousands of payphones that did not even exist.[4]

Edwards, of course, did not execute this scheme all by himself. In fact, he had numerous co-conspirators. Among these were marketing professionals who, fully aware of the true nature of the business plan and ETS's financial condition, promoted and marketed the sale and leaseback of the payphones. A nationwide network of agents and brokers

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[3] Accordingly, for example, a payphone owner whose phone was located at Atlanta's Hartsfield-Jackson International Airport and generated $1,000 per month in coin revenue was promised the same rate of return as the owner whose phone was located behind a dilapidated service station in the middle of the desert and generated only $1 per month.

[4] ETS ultimately sold approximately 13,000 more payphones than it actually owned.

further assisted him in the sale of the phones to the investing public. Like the marketing professionals, many of these agents and brokers continued to earn significant commissions promoting and selling ETS's product long after becoming aware of the fraudulent nature of the scheme.[5] While seemingly extraordinary, tactics of this nature were well worth the effort: ETS's agents and marketing professionals earned substantial commissions (no less than $200 million in the aggregate), in addition to lavish vacations and other prizes bestowed by Edwards (through ETS).

The final—and probably most important—component of ETS's marketing and sales machine was a group of Individual Retirement Account ("IRA") custodians. These IRA custodians significantly increased the scale of the scheme by reaching a whole new category of investors—elderly retirees. Essentially, the IRA custodians provided a mechanism by which these people could easily transfer all or a portion of their savings (often their entire life savings) from their existing IRA accounts to a new IRA account for conversion into ETS payphone investments. Specifically, an ETS agent would contact a potential investor who would show interest in the payphone investment but would be unable to purchase the phone because of the lack of available funds. The agent would then ask whether the investor had money in a retirement account. If so, the agent would describe the mechanism by which some or all of the funds from the investor's existing IRA could be transferred into a new IRA for the purpose of buying payphones. The investor would then sign a preprinted form enabling the IRA custodians to transfer the funds. The IRA custodians would then facilitate the conversion of IRA funds into payphone investments, and often

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[5] One such agent, John Prokop, was an original defendant in this case. The Petitioner settled all claims against Prokop while the case was on appeal in the Eleventh Circuit, however, and thus Prokop is no longer a party to these proceedings.

even sign the lease agreement on behalf of the individual investor.

Respondents Reliance Trust Company, PENSCO, Inc. and Community National Bank were the three principal IRA custodians[6] integral to the perpetuation of the scheme, and had knowledge of the scheme while assisting in its execution. Like the marketing professionals and agents, the IRA Custodians benefited greatly from their participation in the plan, through the payment of various fees and the increase in assets they were able to hold out to the public as being under their management.

As with all Ponzi schemes, the payphone scheme finally crashed, forcing ETS and related entities to file Chapter 11 bankruptcy on September 11, 2000.[7] In the wake of the crash, Edwards was removed from his position as President, CEO, and sole shareholder of ETS, and was ultimately indicted and convicted under an 82-count federal indictment.[8]

The victims of the scheme are two-fold: (1) the investors—typically elderly or retired individuals who lost most, if not all, of their life savings, and (2) ETS itself. Although the remaining, legitimate portion of ETS's payphone business

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[6] Hereafter, Reliance, PENSCO, and Community National Bank are referred to collectively as the "IRA Custodians."

[7] The bankruptcy case involves a number of debtors, including ETS Payphones, Inc., PSA, Inc., ETS Vending, Inc., and other related entities. The case is styled *In re PSA, Inc., a Delaware Corporation, and Affiliates*, Case No. 00-3570 (JCA), in the United States Bankruptcy Court for the District of Delaware.

[8] *See United States v. Edwards*, Criminal Indictment No. 1:04-CT-329, in the United States District Court for the Northern District of Georgia, Atlanta Division; *id.*, Judgment In A Criminal Case entered March 8, 2006. Edwards and certain other ETS insiders were among the original defendants in this case. The Petitioner has since settled his claims against those individuals, however, and thus they, too, are no longer parties to this case.

was salvaged as part of a plan of reorganization, the value of the reorganized business is less than five percent (5%) of the losses inflicted upon the victims. These victims comprise the overwhelming majority of the creditor body in the bankruptcy case.

This case arose in the course of the ETS bankruptcy case. The Joint Plan of Reorganization confirmed by the Bankruptcy Court created the ETS Creditors' Litigation Trust, and the Court appointed Petitioner Darryl S. Laddin as Trustee. The Petitioner then pursued litigation against various defendants, including Respondents, the IRA Custodians.

In his Third Amended Complaint in this action, the Petitioner asserted claims against the Respondents for, *inter alia*, violations of the RICO Act.[9] Each of the IRA Custodians brought a motion to dismiss, challenging the Petitioner's standing to assert the claims and asserting the affirmative defense of *in pari delicto*. The district court granted the motion and dismissed the RICO claims against all of the Respondents.[10] In its ruling, the district court rejected the Respondents' standing arguments, but applied the defense of *in pari delicto* to bar the Petitioner's RICO claims.

Petitioner appealed, *inter alia*, the district court's dismissal of his RICO claims to the Eleventh Circuit. Petitioner contended (1) that Section 541(a) of the United States Bankruptcy Code, 11 U.S.C. § 541(a), does not mandate application of the personal, equitable defense of *in pari delicto* against a bankruptcy trustee, barring his claims against wrongdoing third parties to the detriment of innocent investors and other creditors of the estate; (2) that, in any event, the *in pari delicto* defense does not apply to causes of action arising under the RICO Act; and (3) that, even if the *in*

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[9] 18 U.S.C. §§ 1962(c)-(d).

[10] *See* Exhibit A hereto.

pari delicto defense does bar RICO claims brought by a wrongdoer, it does not apply to RICO claims brought by a bankruptcy trustee, given the strong policies of compensation and deterrence embodied in the RICO Act and equitable principles favoring distributions to creditors embodied in the Bankruptcy Code.

In its order on appeal,[11] the Eleventh Circuit affirmed the district court's dismissal of the RICO claims against the Respondents. The Eleventh Circuit reasoned that the express terms of Section 541(a) of the Bankruptcy Code subject a bankruptcy trustee to any and all affirmative defenses—including such personal, equitable defenses as *in pari delicto*—that would have been assertable against the debtor. Characterizing the terms of Section 541(a) as "unambiguous," the Eleventh Circuit refused to consider language in the legislative history expressly indicating that Congress intended precisely to the contrary. The Eleventh Circuit also noted that all of the other Circuit Courts of Appeals that have addressed the issue to date have reached the same conclusion, and dismissed the chorus of recent commentators—discussed *infra*—who insist that Section 541(a) in no way requires a bankruptcy trustee to be subject to the *in pari delicto* defense, and that the prior decisions of courts to the contrary are unnecessary, unjust and inequitable. Finally, the Eleventh Circuit determined that the *in pari delicto* defense is applicable to RICO claims, in particular, that are asserted by a co-conspirator or co-wrongdoer, and thus also bars claims asserted by a bankruptcy trustee who has succeeded to the interests of such a party under Section 541(a).

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[11] *See* Exhibit B hereto.

REASONS FOR GRANTING THE WRIT

I. This Case Presents The Court With An Issue Of Unquestionable, National Importance, And An Opportunity To Reverse The Trend Of Incorrect, Ill-Founded And Roundly Criticized Decisions Rendered By The Circuit Courts To Date.

This case presents the Court with the opportunity to issue the definitive ruling on an issue of first impression and profound, national importance—the applicability of the *in pari delicto* defense to an innocent bankruptcy trustee—and to correct, once and for all, the consistently unjust and ill-founded rulings issued by the Eleventh Circuit here, and indeed by all of the Circuit Courts that have addressed the question to date. As a result of these rulings, a bankruptcy trustee is currently powerless to pursue claims against parties who aided and abetted wrongful acts committed by now-banished principals and agents of a debtor, even when the sole beneficiaries of such claims would be the innocent victims of the wrongdoing. Countless numbers of innocent creditors, in any case where the insolvency of the debtor was caused by the fraudulent acts of its principals, are thus denied their only potential source for any recovery whatsoever.

To add insult to injury, this result is not even mandated under the applicable provision of the Bankruptcy Code. As explained herein, and contrary to the conclusion reached below, Congress has made it abundantly clear that Section 541 of the Code does not require application of the *in pari delicto* defense to a bankruptcy trustee, barring his claims against wrongdoing third parties to the detriment of innocent investors and other creditors of the estate. For this reason, a growing chorus of commentators,[12] and at least one bank-

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[12] *See* Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate*, 21 EMORY BANKR. DEV J. 519 (Summer 2005); Tanvir Alam,

ruptcy judge,[13] have harshly criticized the prior appellate rulings on the issue and called for them to be overturned. With this case, and in one fell swoop, the Court can do just that.

A. The Eleventh Circuit's ruling that Section 541 requires application of the *in pari delicto* defense to a bankruptcy trustee has no basis in the plain language of the statute, and is directly inconsistent with Congress' clear and unequivocal expression of its intent.

Under Section 541 of the Bankruptcy Code, the filing of a bankruptcy petition creates an estate. The estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case."[14] As the legislative history of Section 541 reflects, causes of action belonging to the debtor fall within this definition.[15] And, as a general proposition, Section 541 "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case."[16]

Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How In Pari Delicto Has Been Perverted to Prevent Recovery for Innocent Creditors, 77 AM. BANKR. L.J. 305 (Summer 2003); Gerald L. Baldwin, *In Pari Delicto Should Not Bar a Trustee's Recovery*, 23 AM. BANKR. INST. J. 8 (Oct. 2004); *Making Sense of the In Pari Delicto Defense: "Who's Zoomin' Who?"* 23 No. 11 BANKR. LAW LETTER 1 (Nov. 2003); Robert T. Kugler, *The Role of Imputation and In Pari Delicto in Barring Claims Against Third Parties*, 1 No. 14 ANDREWS BANKR. LIT. REP. 13 (2004).

[13] *Tolz v. Proskauer Rose LLP (In re Fuzion Tech.Group, Inc.)*, 332 B.R. 225 (S.D. Fla. 2005).

[14] 11 U.S.C. § 541(a).

[15] 11 U.S.C.A. § 541 note (West 2004) (Revision Notes and Legislative Reports—1978 Acts); 1978 U.S.C.C.A.N. 5963, 6323-24.

[16] *Id.*

Relying on this legislative history and the statute's phrase "as of the commencement of the case," many courts, including the district and appellate courts in this case, have construed Section 541 as requiring a blind application to the bankruptcy trustee of all defenses to which the debtor would have been subject under non-bankruptcy law as of the moment of bankruptcy.[17] This construction is incorrect, however, for many reasons, not the least of which is that the bankruptcy court is a court of equity, and equity is not served by applying defenses personal to the debtor to bar a trustee from pursuing claims to the detriment of innocent victims and the benefit of wrongdoers. Section 541 does not mandate such a result.

Like certain other courts, the lower courts in this case felt bound by the perceived restrictions of Section 541, based on the legislative history limiting the trustee to "no greater rights than the debtor himself had."[18] Significantly, however, Section 541's legislative history also expressly states that defenses that are "personal against the debtor" are *not* effective against the estate:

> Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case. To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate

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[17] *See, e.g., Sender v. Buchanan (In re Hedged-Investments Assocs.)*, 84 F.3d 1281, 1285-86 (10th Cir. 1996); *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 356 (3d Cir. 2001).

[18] *See* 11 U.S.C.A. § 541 note (West 2004) (Revision Notes and Legislative Reports—1978 Acts; 1978 U.S.C.C.A.N. 5963, 6323-24.

> *except to the extent that defenses which are personal against the debtor are not effective against the estate.*[19]

Although this portion of the legislative history has been inexplicably overlooked by most courts, its validity is recognized by numerous, highly respected authorities on bankruptcy law and at least one court.[20]

At a minimum, the seemingly absolute limit on the trustee's power to assert a claim—"He could take no greater rights than the debtor himself had"—is clearly contradicted by the more specific mitigating language "except to the extent that defenses which are personal against the debtor are not effective against the estate." By ignoring or—in the case of the Eleventh Circuit here—refusing to consider the second phrase, courts have found the legislative history more restrictive than it really is. Hence, under a complete reading of Section 541's legislative history, a bankruptcy trustee is subject to the same defenses to which the debtor is at the moment of bankruptcy, *except* those defenses that are "personal" against the debtor. Indeed, the Latin phrase *in pari delicto* refers to a plaintiff's participation in the same wrongdoing as the defendant.[21] It is a defense that prevents a

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[19] 11 U.S.C.A. § 541 note (West 2004) (Legislative Statements) (emphasis added); 124 CONG. REC. 32,399 (1978).

[20] *See, e.g.*, 5 COLLIER ON BANKRUPTCY ¶ 541.04 (15th rev. ed. 2004) ("To the extent an interest is limited in the hands of the debtor, it is equally limited as property of the estate *except to the extent that defenses which are personal against the debtor are not effective against the estate.*" (emphasis added)); Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate*, 21 EMORY BANKR. DEV. J. 519, 538-39 (Summer 2005) (same). *See also In re Fuzion Tech.*, 332 B.R. at 231-232 (same).

[21] The doctrine of *in pari delicto* has its root in the Latin phrase, *in pari delicto potior est conditio defendentis*, which translates to mean, "in the case of equal or mutual fault, the position of the defending party is the better one." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306, 105 S. Ct. 2622, 2626 (1985).

plaintiff who has participated in wrongdoing from recovering damages resulting from the wrongdoing.[22] Accordingly, the primary focus of the defense is on the personal malfeasance of the individual seeking to recover damages. This is the epitome of a "personal" defense of the sort that Congress has plainly indicated should not be assertable against a bankruptcy estate or trustee.[23]

B. The Eleventh Circuit's ruling that Section 541 is so "unambiguous" as to prohibit consideration of its legislative history creates a split in the Circuits, and a departure from prior rulings by this Court, on that issue.

In the present case, however, the Eleventh Circuit refused even to consider the legislative history of Section 541, based on its conclusions (1) that the provision is "unambiguous," and thus any consideration of legislative history is not warranted, and (2) that the portion of the legislative history on which the Trustee relies pertains solely to Section 541(d) rather than Section 541(a).[24] Both of these conclusions are demonstrably incorrect, and conflict with both rulings by the other Circuit Courts and prior opinions of this Court.

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[22] *In re Fuzion Tech.*, 332 B.R. at 232-233.

[23] *See, e.g., Exxon Corp. v. Oxxford Clothes, Inc.*, 109 F.3d 1070, 1078 n.11 (5th Cir. 1997) (equitable defenses are personal defenses); *Pyrodyne Corp. v. Pyroteronics Corp.*, 847 F.2d 1398, 1402 (9th Cir. 1988) (same); *Hrisomalos v. Smith*, 600 N.E.2d 1363, 1366 (Ind. Ct. App. 1992) (equitable defenses like unclean hands are personal defenses); *Resolution Trust Corp. v. Associated Gulf Contractors, Inc.*, 622 A.2d 1324, 1330-31 (N.J. Super. Ct. App. Div. 1993) (same); *Nomura Sec. Int'l, Inc. v. E*Trade Sec., Inc.*, 280 F. Supp. 2d 184, 196-97 (S.D.N.Y. 2003) (*in pari delicto* is analogous to the doctrine of unclean hands).

[24] *Laddin v. Edwards (In re PSA, Inc.)*, 437 F.3d 1145, 1150 (11th Cir. 2006); Appendix B at 18a-19a.

First, the plain language of Section 541 does not address *in pari delicto* or, for that matter, any defenses or their applicability to bankruptcy estates or trustees. Rather, the language defining "property of the estate"—inarguably among the most fundamental provisions of the Bankruptcy Code—is exceptionally broad, and its proper construction and application plainly warrant an inquiry into the legislative history of the statute.

Not surprisingly, therefore, courts have routinely looked to Section 541's legislative history for guidance in construing the broad language of the statute. For example, after noting in *Miller v. Shallowford Cmty. Hosp. Inc.*, that Section 541(a)(1) "broadly defines" the property of a debtor's estate to include "all legal or equitable interests," even the Eleventh Circuit looked to legislative history to determine which legal and equitable interests are included in the property of the estate.[25]

Indeed, both this Court and all of the Circuit Courts of Appeals have utilized legislative history to interpret Section 541.[26] Moreover—and although they missed or ignored the

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[25] 767 F.2d 1556, 1559 (11th Cir. 1985) (citing S. REP. NO. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868 (the "Senate Report"); H.R. REP. NO. 595, 95th Cong., 1st Sess. 367, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6323 (the "House Report") ("The legislative history [of 11 U.S.C. § 541 (a)(1)] indicates that [the] definition [of property of the estate] includes causes of action . . . ."). *See also Johnson, Blakely, Pope, Bokor, Ruppel & Burns, P.A. v. Alvarez* (*In re Alvarez*), 224 F.3d 1273, 1278 n.12 (11th Cir. 2000) (same); *T & B Scottdale Contractors, Inc. v. United States*, 866 F.2d 1372, 1376 (11th Cir. 1989) (citing to the Senate and House Reports in construing section 541(a)(1)).

[26] *See, e.g., United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204-05 n.8-9 (1983) (relying on legislative history to observe that in enacting section 541(a)(1) "Congress intended a broad range of property . . . to be included in the estate"); *Tringali v. Hathaway Mach. Co., Inc.*, 796 F.2d 553, 560 (1st Cir. 1986); *Rodgers v. County of Monroe* (*In re Rodgers*), 333 F.3d 64, 69 (2d Cir. 2003) (per curiam); *L.R.S.C. Co. v. Rickel Home*

critical portion of it, and consequently reached the wrong result—even other Circuit Courts faced with the very issues raised in this case have looked to the legislative history for guidance in interpreting the scope of Section 541(a),[27] thus indicating, at least implicitly, that they considered the text of the statute sufficiently unclear and ambiguous to warrant such an analysis. The very fact that other Circuit Courts have reached a contrary conclusion not only indicates a split in the circuits on this issue, but also belies, by definition, the Eleventh Circuit's determination in this case that Section 541 is so plainly unambiguous as to make reference to the legislative history impermissible.[28]

Second, while courts have certainly used the above-referenced portion of the legislative history to interpret Section 541(d), this does not mean its application is limited to that section. In fact, *Collier on Bankruptcy* relies on this

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Ctrs., Inc. (In re Rickel Home Ctrs., Inc.), 209 F.3d 291, 297 (3d Cir. 2000); *Shumate v. Patterson*, 943 F.2d 362, 363 (4th Cir. 1991); *Am. Nat'l Bank v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1274 (5th Cir. 1983); *Weingarten Nostat, Inc. v. Serv. Merch. Co., Inc.*, 396 F.3d 737, 742 (6th Cir. 2005); *In re Paeplow*, 972 F.2d 730, 737 (7th Cir. 1992); *Garner v. Strauss (In re Garner)*, 952 F.2d 232, 234 (8th Cir. 1991); *Computer Commc'n, Inc. v. Codex Corp. (In re Computer Commc'n, Inc.)*, 824 F.2d 725, 729 (9th Cir. 1987); *Sender v. Simon*, 84 F.3d 1299, 1305 (10th Cir. 1996); *United States v. Inslaw, Inc.*, 932 F.2d 1467, 1471 (D.C. Cir. 1991).

[27] *See, e.g., Sender*, 84 F.3d at 1285-1286; *R.F. Lafferty & Co.*, 267 F.3d at 356.

[28] *See, e.g., In re Southern Star Foods, Inc.*, 144 F.3d 712, 715 (10th Cir. 1998) ("The existence of a split in the circuits in the interpretation of [a statute] is, in itself, evidence of the ambiguity of the language."); *Allapattah Servs., Inc. v. Exxon Corp.*, 362 F.3d 739, 747 (11th Cir. 2004) ("While [a] statute's meaning may appear to be obvious to an individual reader, a court cannot responsibly declare language to be 'clear' when, as a matter of empirical reality, significant numbers of jurists have reasonable, good faith disputes over its meaning. A judicial fiat declaring a statute to be unambiguous does not make it so.").

excerpt from the Joint Statement to explain the scope of section 541(a)(1).[29] Further, numerous courts have cited this excerpt while analyzing Section 541(a)(1).[30] Moreover, the excerpt itself expressly states that it is setting forth the premise of Section 541(a)(1):

> Thus, *as section 541(a)(1) clearly states*, the estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case. To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate except to the extent that defenses which are personal against the debtor are not effective against the estate.[31]

While this excerpt immediately follows a description of Section 541(d), the subsequent, explicit reference to subsection (a)(1) is much more general, referring not only to the kinds of defenses that are assertable against the trustee, but also to the kinds that are not. Accordingly, the excerpt not only is *not* exclusive to Section 541(d), it expressly applies *to* Section 541(a)(1).

In short, the district and appellate courts in this case construed Section 541 too narrowly. The legislative history of the statute is crystal clear that "property of the estate" in-

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[29] 5 COLLIER ON BANKRUPTCY ¶ 541.04 (15th ed. rev. 2004).

[30] *See, e.g., In re Combustion Eng'g, Inc.*, 391 F.3d 190, 219 (3d Cir. 2004) (characterizing the excerpt from the Joint Statement as the "Legislative Statement" to section 541(a)(1)); *Huber v. Danning (In re Thomas)*, 147 B.R. 526, 534 (9th Cir. 1992) (Volinn, J., dissenting) (citing to the excerpt from the Joint Statement for the proposition that "the language of section 541 was intended to be generally applicable"); *In re Village Rathskeller, Inc.*, 147 B.R. 665, 671 (Bankr. S.D.N.Y. 1992) (reproducing the excerpt from the Joint Statement in explaining section 541(a)(1)); *In re S.W. Citizens' Org. for Poverty Elimination*, 91 B.R. 278, 281 (Bankr. D.N.J. 1988) (same).

[31] 11 U.S.C.A. § 541 note (West 2004) (Legislative Statements); 124 CONG. REC. 32,399 (1978) (emphasis added).

cludes the debtor's claims unencumbered by any personal defenses. Moreover, the Eleventh Circuit's conclusion that Section 541 is so "unambiguous" as to preclude consideration of that legislative history conflicts directly with prior rulings by this Court and the other Circuit Courts. Accordingly, the IRA Custodians' *in pari delicto* defense is inapplicable to the Trustee's claims in this case, and the Eleventh Circuit's erroneous and ill-founded ruling to the contrary should be reversed.

II. This Case Creates A Split In The Federal Courts On Application Of The *In Pari Delicto* Defense To RICO Claims Generally, And Presents That Issue To This Court For A Definitive Ruling.

The Eleventh Circuit's ruling in this case that the *in pari delicto* defense is applicable to RICO claims, as a general matter, is also in conflict with the conclusions reached by other federal courts on that issue. In evaluating the affirmative defense of *in pari delicto*, state law governs state law causes of action and federal law governs federal law causes of action.[32] Accordingly, where a cause of action arises under a federal statute like RICO, federal policies bear on the question of estoppel defenses like *in pari delicto*.[33] Based on these policies, numerous federal courts have held that the *in pari delicto* defense simply is not applicable to RICO claims in any case or context.[34] Other federal courts

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[32] *See O'Melveny & Myers v. FDIC*, 512 U.S. 79, 84-85, 114 S. Ct. 2048, 2053 (1994); *Schacht v. Brown*, 711 F.2d 1343, 1347 (7th Cir. 1983).

[33] *See Schacht*, 711 F.2d at 1347 ("the cause of action here arises under RICO, a federal statute; we therefore write on a clean slate and may bring to bear federal policies in deciding the estoppel question").

[34] *See, e.g., Harper v. American Tel. and Tel. Co.*, 54 F. Supp. 2d 1371, 1380 (S.D. Ga. 1999) ("In considering the similar common law defense, *in pari delicto*, several courts have held that it is not applicable in federal

have determined that equitable defenses are inapplicable when a plaintiff's claims would further the compensation and deterrent objectives of RICO.[35]

Rather than following any of these authorities, however, and in the absence of conclusive guidance from this Court in the RICO context, the Eleventh Circuit in this case instead engaged in a protracted and tortuous analysis[36] of this Court's rulings in what it deemed to be analogous cases, involving federal securities and antitrust laws based on similar enforcement policies and protective principles.[37] Notwithstanding the fact that this Court declined to apply *in pari delicto* to the claims in both of those cases, moreover, the Eleventh Circuit drew ill-founded distinctions and, with no further basis in or reliance upon relevant case law, concluded that the defense *did* apply to the RICO claims in this case.[38]

The Eleventh's Circuit's opinion here is thus at odds with the conclusions reached by other federal courts on the appli-

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RICO cases."); *In re National Mtg. Equity Sec. Litig.*, 636 F. Supp. 1138 (C.D. Cal. 1986).

[35] *See Schacht*, 711 F.2d at 1348-49, 1359-60 (conducting compensation and deterrent analysis to determine whether insurance company liquidator should be estopped from pursuing RICO claim against accounting firm, and concluding that liquidator was precisely the kind of plaintiff that should have right to pursue such a claim in order to fulfill the deterrent objectives of RICO).

[36] *Laddin*, 437 F.3d at 1152-1156; Appendix B at 22-30a.

[37] *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310-11, 105 S. Ct. 2622, 2629 (1985) (*in pari delicto* defense is allowed in securities fraud case only if "preclusion of suit would not significantly interfere with the effective enforcement of the laws and protection of the public."); *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 140, 88 S. Ct. 1981, 1985 (1968) (refusing to recognize *in pari delicto* as a defense to an antitrust action in light of purposes of antitrust laws).

[38] *Laddin*, 437 F.3d at 1155-1156; Appendix B at 29a-30a.

cability of *in pari delicto* to claims arising under the RICO Act, and inconsistent with this Court's prior rulings in the analogous areas of securities regulation and antitrust. Plainly, the time is right for a definitive ruling by this Court on the precise issue of whether the *in pari delicto* defense applies to RICO claims as a general matter, and this case presents the Court with an opportunity to have the final, conclusive word on that unquestionably prevalent and significant issue.

III. The Results In This Case, And In The Prior Circuit Court Decisions Applying *In Pari Delicto* To Bankruptcy Trustees, Betray The Equitable Principles Embodied In The Bankruptcy Code And Conflict With The Manner—Accentuating Flexibility In The Service Of Equity Rather Than Rote Application—In Which This Court And The Other Federal Courts Have Consistently Directed Section 541 And Other Provisions Of The Bankruptcy Code To Be Administered.

Finally, in a case such as this one, the equitable principles embodied in the Bankruptcy Code preclude the application of an estoppel doctrine like *in pari delicto* to bar a suit by an innocent plaintiff in the nature of a bankruptcy trustee. The question is ultimately a matter of federal policy, and specifically, of the fundamental equitable principles underlying the Bankruptcy Code as a whole. In dismissing the Trustee's claims, the lower courts in this case refused to consider the post-petition removal of the wrongdoer (Edwards) and appointment of an innocent party (the Trustee) seeking recovery for the benefit of innocent investors and other creditors. The courts again felt bound by their conclusion that, under Section 541, defenses must be evaluated and rotely applied solely as they existed at the moment of the bankruptcy, no matter how little sense this may make under the circumstances, and regardless of the extent to which they had to ignore—or even

deny[39]—the inarguable factual realities before them. As demonstrated above, the legislative history of Section 541 does not support such a restrictive interpretation of the statute.

Further, federal courts, specifically including this Court, have historically recognized that rights at the moment of bankruptcy are not the sole determinant of what is property of the estate. Bankruptcy principles and policies play an important role in the analysis and can justify the consideration of post-petition events in order to insure an equitable result. In this regard, the Eleventh Circuit's decision in this case is flatly at odds with prior rulings by this Court. In *Segal v. Rochelle*, for example, this Court allowed a trustee to claim as property of the estate a tax refund for a taxable year that ended post-petition.[40] Permitting the consideration of the post-petition event (the ending of the tax year) for purposes of determining "property of the estate," the Court reasoned that the refund was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property.'"[41] In reaching this conclusion, the Court specifically stated that bankruptcy policy and purposes must

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[39] Among the conclusions reached by the Eleventh Circuit in this case is the stunning assertion that the Trustee's "recovery under RICO [in this case] would not divest RICO violators of their ill-gotten gains, it would result in a wealth transfer among similarly situated conspirators." *Laddin*, 437 F.3d at 1155; Appendix B at 27a. This statement denies the simple reality of the situation, disputed by no one—that the actual perpetrators of any fraud within ETS had been eliminated, that the IRA Custodians were alleged to have violated RICO in their own rights, and that any recovery by the Trustee would inure only to the entirely innocent victims of the scheme.

[40] 382 U.S. 375, 380, 86 S. Ct. 511, 515 (1966). Notably, *Segal* is specifically referenced and approved in the legislative history of Section 541. 11 U.S.C.A. § 541 note (West 2004) (Revision Notes and Legislative Reports—1978 Acts); 1978 U.S.C.C.A.N. 5963, 6323-24.

[41] *Id.*

ultimately govern questions as to what is property of the estate.[42] Accordingly, this Court's focus in *Segal* was not on whether the right to the refund had fully vested at the moment of bankruptcy but, rather, on whether classifying the refund as property of the estate would encumber the bankruptcy policy of giving the debtor a "fresh start."[43]

In *Kokoszka v. Belford,* this Court likewise held that, in determining the scope of the term "property"—and its limitations—the "purposes of the Bankruptcy Act must ultimately govern."[44] The Court in that case concluded that a garnishment statute restricting the garnishment of wages to 25% could not limit the right of the bankruptcy trustee to treat the debtor's entire income tax refund as property of the estate.[45] Again, in its analysis, the Court considered whether the purposes of the Bankruptcy Act—to convert the estate of the bankrupt into cash and distribute it among creditors and to give the bankrupt a fresh start—would be served by including the entire tax refund within the property of the estate despite the applicability of the garnishment statute.[46]

Other federal courts have freely considered post-petition acts in applying other provisions of the Bankruptcy Code as well—all in service of the equitable purposes of the bankruptcy courts and Code. For example, when a claim against the debtor's fraudulent managers is brought by the Trustee under Section 548 of the Bankruptcy Code, a "better rule" prevails on the issue of imputing the manager's fraudulent

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[42] *Id.* at 379, 515.

[43] *Id.* at 379-80, 515.

[44] 417 U.S. 642, 645, 94 S. Ct. 2431, 2433 (1974).

[45] *Id.* at 652, 2437.

[46] *Id.* at 646-47, 2434. *See also Page v. Edmunds*, 187 U.S. 596, 605-06, 23 S. Ct. 200, 203-204 (1903) (seat in stock exchange *held* property of the estate under Bankruptcy Act even though property was exempt under state law).

conduct to the bankruptcy trustee: it's not allowed. Why? Because it "would lead to an inequitable result"—the *in pari delicto* defense would serve "only to bar the claims of an innocent successor."[47] Finally, in the comparable arenas of antitrust and securities law, federal policy often dictates restrictions on the use of *in pari delicto*, requiring courts to carefully consider public policy implications before the defense is allowed.[48]

If, as rulings by the Circuit Courts have thus far indicated, Section 541 is to be the sole exception to the "equity over rote application" approach that this Court and others have consistently mandated for construction and application of the Bankruptcy Code, then this Court needs to say so, clearly and definitively, in this case. If an aberrant principle of bankruptcy law is to deny countless thousands of innocent creditors and investors their only potential source for any recovery whatsoever, then it needs to be a principle announced, justified in light of prior rulings and endorsed by the highest court in the land. The issue is one of critical, national importance, because Section 541—the section that defines property of a debtor's estate—is among the most fundamental provisions in the entire Code, and because the facts and equities presented here have been, and will continue to be, duplicated in every case involving a corporate debtor ren-

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[47] *See McNamara v. PFS (In re The Personal & Bus. Ins. Agency)*, 334 F.3d 239, 241 (3d Cir. 2003). *See also PM Denver, Inc. v. Porter (In re Porter McLeod, Inc.)*, 231 B.R. 786, 794-95 (D. Colo. 1999) (refusing to apply *in pari delicto* defense under Section 544(a) where application of the doctrine would not be in the public interest); *Anstine v. Alexander*, 128 P.3d 249, 254-255 (Colo. App. 2005).

[48] *See Bateman*, 472 U.S. at 310-11, 105 S. Ct. at 2629 (*in pari delicto* defense is allowed in securities fraud case only if "preclusion of suit would not significantly interfere with the effective enforcement of the laws and protection of the public."); *Perma Life Mufflers*, 392 U.S. at 140, 88 S. Ct. at 1985 (refusing to recognize *in pari delicto* as a defense to an antitrust action in light of purposes of antitrust laws).

dered insolvent by the fraud of its principals. Unfortunately, and as exemplified in recent years by companies such as Enron and Worldcom, such cases are becoming only more and more prevalent.

In sum, while the relevant substantive law is important in determining the rights a party has under a federal statute, courts across the board recognize that the federal purposes and policies behind the statute ultimately govern the scope and extent of those rights. In the bankruptcy context, this means that post-petition acts may be considered when doing so would serve the higher cause of preventing inequitable results. Indeed, the Trustee is charged with marshaling the assets of the estate and distributing them in the best interests of the parties. The Trustee "is the last good person who can help the creditors and ensure that the loss is borne by those who caused it and not by innocent people."[49]

Accordingly, the post-petition replacement of Edwards with the Trustee in this case should be relevant (and controlling) to the *in pari delicto* analysis. Indeed, refusing to consider it has the ironic effect of turning the defense on its head—instead of preventing a wrongdoer from profiting from his wrong, the defense shields the wrongdoers from liability and punishes the innocent victims. The equitable policies governing the *in pari delicto* defense and underlying federal bankruptcy law preclude such a perverse result. As best articulated by Chief Judge Posner, writing for the Seventh Circuit in a receivership case:

> [T]he wrongdoer must not be allowed to profit from his wrong by recovering property that he had parted with in order to thwart his creditors. That reason falls apart now that [the wrongdoer] has been ousted from control of and beneficial interest in the corporations. The appointment of the receiver removed the wrongdoer from the scene.

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[49] *In re Fuzion Tech.*, 332 B.R. at 234.

> The corporations were no more [the wrongdoer's] evil zombies. Freed from his spell they became entitled to return of the moneys—for the benefit not of [the wrongdoer] but of innocent investors—that [the wrongdoer] had made the corporations divert to unauthorized purposes.[50]

In other words, the doctrine of *in pari delicto* "loses its sting when the person who was *in part delicto* is eliminated."[51]

While at least one lower court has correctly applied this reasoning in the bankruptcy context,[52] the Eleventh Circuit in this case got it wrong, as have all of the Circuit Courts that have addressed the issue to date. In this case, and with one definitive ruling, this Court can correct those errors and set the lower federal courts on the right course on this seminal issue, once and for all.

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[50] *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995).

[51] *Id.* at 755.

[52] *See In re Fuzion Tech.*, 332 B.R. 225. *See also R.F. Lafferty*, 267 F.3d at 361-63 (Cowen, J. dissenting). In fact, *In re Fuzion* is both the case most precisely on point and the only one in which a court has performed the appropriately thorough analysis—considering *all* of section 541's legislative history, the equitable principles governing the doctrine of *in pari delicto*, the equitable policies governing the Bankruptcy Code, and the policies underlying the applicable federal statute—and reached the correct result, concluding that "as a matter of law, the *in pari delicto* defense does not apply to the bankruptcy trustee." 332 B.R. at 236.

CONCLUSION

For all of the reasons set forth herein, Petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the Eleventh Circuit.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

CIVIL ACTION FILE
NO. 1:02-CV-3327-TWT

DARRYL S. LADDIN,
as Trustee of the ETS Creditors' Litigation Trust,
Plaintiff,

v.

CHARLES EDWARDS, *et al.*,
Defendants.

ORDER

This is an action for breach of fiduciary duty, civil RICO and fraud. It is before the Court on Defendant Reliance Trust Company's Motion to Dismiss Plaintiff's Third Amended Complaint [Doc. 132], Defendant PENSCO, Inc.'s Motion to Dismiss Plaintiff's Third Amended Complaint [Doc. 140], and Defendant Community National Bank's Motion to Dismiss Plaintiff's Third Amended Complaint [Doc. 166]. For the reasons set forth below, the motions to dismiss are GRANTED.

I. *BACKGROUND*

ETS Payphones, Inc. ("ETS") is a Georgia corporation founded by Charles E. Edwards in October 1994. Edwards was the sole shareholder and owner of ETS. ETS promoted and marketed the sale and leaseback of coin-operated telephones as investment opportunities to individuals. An investor would pay a fixed sum to purchase a telephone, and ETS

would lease the telephone back from the investor for a preset fee. ETS advertised a 14 or 15% return on telephone leaseback investments. Further, ETS promised to repurchase the equipment at the end of the lease period or upon 180 days notice, making the investment an ostensibly low risk proposition. Thousands of individuals invested in ETS' leaseback program.

Unfortunately for these investors, the financial condition of ETS was less robust than its sales literature may have suggested. ETS consistently lost money on its telephone operations. As revenue from payphone operations consistently failed to cover ETS' operating expenses and lease payments, ETS needed to keep attracting new investors to meet its obligations to existing investors.

Not everyone lost money in ETS' payphone venture. Charles Edwards operated the leaseback program to his great personal benefit. Edwards received $2.24 million in compensation from ETS and Twinleaf, Inc. between 1998 and 2000. From November 1998 through March 1999, ETS paid $3 million in management fees to an affiliated company owned by Edwards. ETS also transferred over $11 million in interest-free loans to companies controlled by Edwards.

On September 11, 2000, ETS filed for bankruptcy. Pursuant to a Stipulation and Agreed Order Concerning the Investigation of Certain of the Debtors' Claims dated December 7, 2000, the United States Bankruptcy Court for the District of Delaware authorized an Official Committee of Unsecured Creditors ("Creditors' Committee") to assert claims on behalf of ETS and certain affiliates ("Debtors"). In accordance with this Order, the Debtors and the Creditors' Committee created the ETS Creditors' Litigation Trust. They appointed a trustee, Plaintiff Darryl S. Laddin, to assert claims on their behalf.

Having settled ETS' claims against Charles Edwards and several corporate defendants, the Plaintiff asserts claims against numerous Defendants who, he alleges, aided Edwards and ETS in propagating the telephone leaseback program. Defendants Reliance Trust Company, PENSCO, Inc., and Community National Bank (collectively, the "IRA Custodian Defendants") are large holders of individual retirement accounts. The Plaintiff alleges that each of the IRA Custodian Defendants aided brokers and ETS agents by helping investors transfer IRA funds into payphone investments. The Plaintiff asserts claims against the IRA Custodian Defendants for aiding and abetting Edwards's breach of fiduciary duty. The Plaintiff also asserts federal racketeering claims against these Defendants. The IRA Custodian Defendants separately move for dismissal of all of the Plaintiff's claims against them on the grounds that the Plaintiff lacks standing to assert the claims and that the claims are barred by the equitable doctrine of *in pari delicto.*

II. *MOTION TO DISMISS STANDARD*

A complaint should be dismissed under Rule 12(b)(6) only where it appears beyond doubt that no set of facts could support the plaintiff's claims for relief. Fed. R. Civ. P. 12(b)(6); *see Conley v. Gibson*, 355 U.S. 41, 47 (1957); *Linder v. Portocarrero*, 963 F.2d 332 (11th Cir. 1992). In ruling on a motion to dismiss, the court must accept the facts pleaded in the complaint as true and construe them in the light most favorable to the plaintiff. *See Quality Foods de Centro America, S.A. v. Latin American Agribusiness Development Corp., S.A.*, 711 F.2d 989, 994-95 (11th Cir. 1983). Generally, notice pleading is all that is required for a valid complaint. *See Lombard's, Inc. v. Prince Mfg., Inc.*, 753 F.2d 974, 975 (11th Cir. 1985), *cert. denied*, 474 U.S. 1082 (1986). Under notice pleading, the plaintiff need only give the defendant fair notice of the plaintiff's claim and the grounds upon which it rests. *Id.*

III. *DISCUSSION*

The IRA Custodian Defendants contend that the Plaintiff lacks standing to assert the claims outlined in the Third Amended Complaint. The Defendants also argue that even if the Plaintiff has standing, the claims are barred by the equitable doctrine of *in pari delicto*.[1] These twin arguments present this Court with two discrete questions of law: (1) whether the claims asserted by the Plaintiff are brought on behalf of the debtors or on behalf of the creditors; and (2) whether the doctrine of *in pari delicto* bars claims of a debtor's trustee when the debtor corporation's sole shareholder is primarily responsible for the bad acts causing the debtors' and creditors' loss.[2]

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[1] The IRA Custodian Defendants also contend that the Plaintiff's claims for aiding and abetting a breach of fiduciary duty fail as a matter of law because Georgia has not recognized this cause of action. *Monroe v. Board of Regents of University System of Georgia*, 268 Ga. App. 659, 664 (2004); *see also Munford, Inc. v. Valuation Research Corp.*, 98 F.3d 604, 613 (11th Cir. 1996) (declining to extend aider and abettor liability to breaches of fiduciary duty, as "Georgia courts would not recognize such a cause of action"); *Time Warner Entertainment Co., L.P. v. Six Flags Over Georgia, LLC*, 245 Ga. App. 334, 342 (2000) (discussing viability of claim for aiding and abetting breach of fiduciary duty, but denying jurisdiction to consider claim). As discussed *infra*, the claims against the IRA Custodian Defendants are barred by the doctrine of *in pari delicto*. Thus, the Court need not reach the question of whether Georgia law supports a claim for aiding and abetting a breach of fiduciary duty.

[2] It bears noting as an initial matter that the Defendants appear to merge analysis of standing and analysis of the doctrine of *in pari delicto*. Standing does not include consideration of affirmative equitable defenses, such as *in pari delicto*. *See Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 346-47 (3d. Cir. 2001); *In re Dublin Securities, Inc.*, 133 F.3d 377, 380 (6th Cir. 1997). "Whether a party has standing to bring claims and whether a party's claims are barred by an equitable defense are two separate questions, to be addressed on their own terms." *Lafferty*, 267 F.3d at 346-47. Here, the equitable defense of *in pari delicto*, suggesting, at most, that the Plaintiff's injury does

A. *Standing*

In Georgia, "each corporation is a separate entity, distinct and apart from its stockholders." *Hickman v. Hyzer*, 261 Ga. 38, 39 (1991); *R.W. Holdco, Inc. v. Johnson*, 267 Ga. App. 859, 866 (2004). A corporation and even its sole owner are two wholly separate and distinct persons. *Shelby Ins. Co. v. Ford*, 265 Ga. 232, 233 (1995); *Jerry Dickerson Presents, Inc. v. Concert Southern Chastain Promotions*, 260 Ga. App. 316, 326 (2003). It follows, then, that a corporation may suffer injury and may assert claims to recover for injury which are wholly separate from those of its stockholders or creditors. Causes of action belonging to a debtor corporation are considered property of the debtor's estate and may be asserted by the trustee of the debtor. 11 U.S.C. § 541(a)(1). Here, the ETS Creditors' Litigation Trust Agreement ("Trust Agreement") provides that the Debtors and the Creditors' Committee assigned to the trustee "all of the Debtors' right, title, and interest" in claims of the Debtors and the Creditors' Committee. (Memo. Supp. Def. RTC's Mot. Summ J., Ex. A at 2). The trustee Plaintiff, thus, has standing to assert claims belonging to ETS, the debtor corporation.

It is well established that a trustee in bankruptcy with standing to assert claims belonging to a debtor does not, by extension, have standing to sue third parties on behalf of the creditors of the debtor. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 434 (1972); *E.F. Hutton & Co., Inc. v. Hadley*, 901 F.2d 979, 987 (11th Cir. 1990). Thus, this Court must determine whether the claims asserted by the trustee Plaintiff properly belong to the debtor corporation ETS or to ETS creditors. In cases involving bankruptcy, distinguishing debtors' claims from creditors' claims can

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not warrant redress, does not refute the Plaintiff's contentions that he suffered injury in fact and such injury could be redressed. Thus, this Court will address the issues of standing and *in pari delicto* separately.

prove difficult. This is because creditors are often the ultimate beneficiaries of the proceeds of the debtors' claims. But "[t]o find that the trustee has no standing to pursue causes of action belonging to the debtor because the recovery would only benefit the creditors is an absurd argument, given the fact that the trustee's goal is to make a distribution to creditors." *In re Plaza Mortgage and Finance Corp.*, 187 B.R. 37, 42 (Bankr. N.D. Ga. 1995); *see also O'Halloran v. First Union Nat. Bank of Florida*, 350 F.3d 1197, 1203-04 (11th Cir. 2003) ("Where, as here, the trustee is litigating in concert with investors, and the trustee may be able to assert injuries not duplicative of those suffered by the investor plaintiffs, we find the concern that the trustee is somehow displacing the rights of the investors to be misplaced."). Nonetheless, although background allegations may also support claims belonging to creditors, a trustee may assert only causes of action belonging to the debtor and may plead for recoveries based on injury to the debtor and not to the creditors. *Id.* at 44.

The trustee Plaintiff's Second Claim for Relief is a claim for "aiding and abetting breach of fiduciary duty *to creditors*." (Third Am. Compl. ¶¶ 161-64) (emphasis added). After alleging that the IRA Custodian Defendants provided a vehicle for Edwards's fraudulent business plan and enabled investors to partake in the ETS scheme, the Plaintiff concludes that the Defendants "knowingly aided, abetted and participated in Edwards's breach of his fiduciary duties to Creditors, causing losses to the Creditors in an amount to be determined at trial." *Id.* ¶ 161. On its face, this count asserts a claim belonging to the creditors and requests damages measured by the loss to these creditors. Indeed, the language of the Second Claim for Relief essentially echoes that of the First Claim for Relief, substituting only the term "Creditors" for "Debtors." This only reinforces the notion that the Debtors' claims are not diminished by failure to consider this claim, which is styled as a breach of duty to creditors. The law does not provide ETS or the Creditors' Committee the

authority to assign the claims belonging to ETS creditors to a litigation trust. Even if the law supported such an action, the terms of the Trust Agreement do not provide the trustee Plaintiff with the authority to bring this claim on behalf of the ETS creditors. Thus, the Plaintiff has no standing to assert the Second Claim for Relief in the Third Amended Complaint, and this claim must be dismissed.

B. *In Pari Delicto*

Having determined that the trustee Plaintiff has standing to assert the Debtors' claims, this Court now addresses the IRA Custodian Defendants' assertion of the doctrine of *in pari delicto* as an affirmative defense against those claims. Under both Georgia and federal law, *in pari delicto* is an equitable doctrine. *Banco Industrial de Venezuela, C.A. v. Credit Suisse*, 99 F.3d 1045, 1050 (11th Cir. 1996); *Bell v. Sasser*, 238 Ga. App. 843, 848 (1999). The doctrine of *in pari delicto* provides that "a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing." *Black's Law Dictionary* 806-07 (8th ed. 2004). The doctrine prevents a plaintiff from recovering on claims for which the plaintiff bears fault equal to or greater than that of the defendant.

The Third Amended Complaint clearly alleges that Charles Edwards, the sole shareholder of ETS and primary architect of the payphone scheme, is responsible for the wrongs for which the Plaintiff sues the Defendants. Whether the *in pari delicto* doctrine applies to this case depends on whether Charles Edwards's conduct can be imputed to ETS and whether defenses against ETS apply with equal strength against the trustee Plaintiff. As this Court answers each of these questions in the affirmative, the doctrine of *in pari delicto* bars the Plaintiff's claims against the Defendants.

1. *Imputation of Edwards's Conduct to ETS*

In order to determine whether the doctrine of *in pari delicto* bars the trustee from asserting claims based on ETS' conduct, this Court must determine whether conduct committed by Charles Edwards may be imputed to ETS. State law governs the imputation of knowledge to corporate victims of alleged wrongdoing. *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 84-85 (1994). The parties appear to agree that Georgia law governs the issue in this case and that Georgia state courts have yet to address the imputation of a sole shareholder's knowledge to his wholly-owned corporation. Where state law has not specifically addressed imputation, federal courts must resolve the issue. *Id.* at 90-91 (Stevens, J., concurring). The Plaintiff contends that the adverse interest exception bars imputation of Edwards's acts to ETS. In Georgia, "[w]hen the officer or agent departs from the scope of his duties and acts in such a way that his private interest outweighs his obligation as a corporate representative, the law will not impute his knowledge to the corporation." *Martin v. Chatham County Tax Comm'r*, 258 Ga. App. 349, 350-51 (2002); *Keenan v. Hill*, 190 Ga. App. 108, 111 (1989). The adverse interest exception, however, does not apply where the offending officer is the sole shareholder of the corporation. *In re Plaza Mortgage and Finance Corp.*, 187 B.R. at 45 n.6.

> The adverse interest exception is an exception to the general rule that a corporation is charged with constructive knowledge of all material facts of which its officers or agents acquire knowledge. . . . The "sole representative" or "sole actor" doctrine is an exception to the adverse interest exception. In cases where the business or transaction in question is entrusted to an officer or agent of the corporation as its sole representative, the adverse interest exception does not apply and the knowledge of the officer or agent is imputable to

> the corporation. The reason for the rule is that, where the officer in question is the sole representative of that corporation, there is no one to whom to impart his knowledge and no one from whom he may conceal it.

Id. The language of the Plaintiff's allegations only reinforces the notion that Edwards's knowledge and conduct of the payphone Ponzi scheme may be imputed to ETS. Paragraph 61 of the Third Amended Complaint states:

> With Edwards at its helm, ETS devised the scheme and promoted and marketed the sale and leaseback of payphones as investment opportunities to individuals. ETS, with the aid of the Marketing Defendants, the Agent Defendants, and the IRA Custodians, created marketing and promotional materials to be provided to potential investors and induce them to purchase the phones. The marketing materials promised returns on the payphone investment of 14% or 15%. Furthermore, ETS promised to repurchase the phones from the investor at any time. Thus, ETS represented itself as, essentially, a no loss proposition. Thousands of investors bought the pitch.

(Third Am. Compl. ¶ 61). Both the "sole actor" doctrine and the Plaintiff's allegations dictate imputing Edwards's misconduct to ETS.

2. *ETS and the ETS Creditors' Litigation Trust*

Having determined that the actions of sole shareholder Charles Edwards may be imputed to ETS, this Court must now address whether the Plaintiff stands in the shoes of the debtor with respect to the *in pari delicto* defense. The Plaintiff argues that the position of a bankruptcy trustee is analogous to that of a court-appointed receiver. *F.D.I.C. v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995); *Scholes*

v. Lehmann, 56 F.3d 750, 753 (7th Cir. 1995). The Plaintiff cites the Ninth Circuit in *O'Melveny* for the proposition that:

> [A] receiver, like a bankruptcy trustee and unlike a normal successor in interest, does not voluntarily step into the shoes of the [entity in receivership or bankruptcy]; it is thrust into those shoes. It was neither a party to the original inequitable conduct nor is it in a position to take action prior to assuming the [entity in receivership or bankruptcy's] assets to cure any associated defects. . . .

O'Melveny, 61 F.3d at 19 (quoting *F.D.I.C. v. O'Melveny & Myers*, 969 F.2d 744, 751-52 (9th Cir. 1992)). The Plaintiff argues that a bankruptcy trustee, like a court-appointed receiver, is a wholly innocent party and, as such, is not subject to the doctrine of *in pari delicto*. Indeed, as noted by the Third and Tenth Circuits, such a holding may be doctrinally sound and may comport with the interests of public policy. *Lafferty*, 267 F.3d at 357; *In re Hedged-Investments Associates, Inc.*, 84 F.3d 1281, 1285 (10th Cir. 1996). Such a holding, however, would also contravene the express language of 11 U.S.C. § 541.

Section 541 applies to bankruptcy trustees, distinguishing this set of plaintiffs from court-appointed receivers. 11 U.S.C. § 541(a). The bankruptcy trustee—in this case, the trustee of the ETS Creditors' Litigation Trust—is the representative of the bankruptcy estate. 11 U.S.C. § 323(a). Under section 541, the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement" of the bankruptcy. 11 U.S.C. § 541(a). These legal and equitable interests include causes of action belonging to the debtor. *Lafferty*, 267 F.3d at 356; *In re Hedged-Investments Associates, Inc.*, 84 F.3d at 1285. Courts have consistently given effect to Congress' decision to limit estate property to those interests existing "as of the commencement" of the bankruptcy. *Lafferty*, 267 F.3d at 356; *In re Hedged-Investments*

Associates, Inc., 84 F.3d at 1285. The phrase "places both temporal and qualitative limitations on the reach of the bankruptcy estate." *In re Hedged-Investments Associates, Inc.*, 84 F.3d at 1285. In the qualitative sense, the phrase establishes that the rights of the estate are no stronger than they were when held by the debtor. *Id.; see also Bank of Marin v. England*, 385 U.S. 99, 101 (1966) ("The trustee succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition."). The legislative history of the Bankruptcy Reform Act reinforces this interpretation of section 541. The Senate and House reports to the Act note:

> Though [Section 541] will include choses in action and claims by the debtor against others, it is not intended to expand the debtor's rights against others more than they exist at the commencement of the case. For example, if the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations, then the trustee would not be able to pursue that claim, because he too would be barred. He could take no greater rights than the debtor himself had.

Lafferty, 267 F.3d at 356 (citing S. Rep. No. 95-989, at 82 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868; H.R. Rep. No. 95-595, at 368 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6323). Under section 541, a trustee may assert a cause of action belonging to a debtor, but the cause of action remains subject to any defenses that could have been raised against it if brought by the debtor at the commencement of bankruptcy. Here, as claims brought by ETS against the Defendants would be barred by the doctrine of *in pari delicto*, the claims asserted by the trustee of the ETS Creditors' Litigation Trust, standing in the shoes of ETS, are similarly barred. The Plaintiff's claims against the IRA Custodian Defendants should be dismissed.

IV. *CONCLUSION*

For the reasons set forth above, Defendant Reliance Trust Company's Motion to Dismiss Plaintiff's Third Amended Complaint [Doc. 132], Defendant PENSCO, Inc.'s Motion to Dismiss Plaintiff's Third Amended Complaint [Doc. 140], and Defendant Community National Bank's Motion to Dismiss Plaintiff's Third Amended Complaint [Doc. 166] are GRANTED.

SO ORDERED, this 16 day of February, 2005.

/s/ Thomas W. Thrash
THOMAS W. THRASH, JR.
United States District Judge

APPENDIX B

[PUBLISH]

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

[Filed January 30, 2006]

D. C. Docket No. 02-03327-CV-TWT-1

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PSA, INC., *et al.*, on behalf of PSA, INC., *et al.*,
Plaintiff,

TRUSTEE DARRYL S. LADDIN,
of the ETS Creditors' Litigation Trust,
Plaintiff-Appellant,

versus

CHARLES EDWARDS, *et al.*,
Defendants,

LEGENDS COMMUNICATIONS, INC., SHELDON E. FRIEDMAN, FRIEDMAN, DEVER & MERLIN, LLC, PWH, INC., d.b.a. FRIEDMAN, DENVER & MERLIN, LLC d.b.a. SHELDON E. FRIEDMAN, KARLOVEC FINANCIAL, INC., RELIANCE TRUST COMPANY, PENSCO, *et al.*,
Defendants-Appellees.

Appeal from the United States District Court
for the Northern District of Georgia

(January 30, 2006)

Before CARNES, HULL and PRYOR, *Circuit Judges*.

PRYOR, *Circuit Judge*:

This appeal presents two issues, the first of which is an issue of first impression in this Circuit: (1) whether the doctrine of *in pari delicto* bars a trustee's claims on behalf of a bankrupt debtor for violations of the Racketeer Influenced and Corrupt Organizations Act; and (2) whether the trustee can maintain a claim for aiding and abetting a breach of fiduciary duties under Georgia law. *See* 11 U.S.C. § 541(a); 18 U.S.C. § 1964(c). Darryl S. Laddin is the trustee-in-bankruptcy for ETS, which operated a massive Ponzi scheme that defrauded thousands of investors of hundreds of millions of dollars. Laddin appeals an order that dismissed his complaint, under RICO and Georgia law, against entities that, Laddin alleges, assisted ETS in the operation of its fraudulent scheme. Because the defense of *in pari delicto* bars recovery by a central and active violator of RICO and Georgia courts do not recognize a claim for aiding and abetting a breach of fiduciary duties, we affirm the dismissal of Laddin's complaint.

I. BACKGROUND

In his complaint, Laddin alleged that in October 1994, Charles Edwards formed ETS Payphones, Inc., a company that sold and leased-back payphones as investment opportunities. "With Edwards at its helm, ETS devised [a] scheme" where an investor paid a fixed sum to purchase a payphone, and ETS leased the payphone back from the investor for a fee. "ETS represented itself as . . . a no loss proposition" and induced individuals to purchase the phones. Although "ETS . . . created marketing and promotional materials that promised returns . . . of 14% or 15%," it consistently lost money on its payphone operations and continually had to attract new investors to meet its obligations to existing investors. "[W]ith the sale of each phone, ETS assumed a liability it could not

satisfy." The operation of the sale-leaseback program was a Ponzi scheme that defrauded thousands of investors of over $300 million. As the sole shareholder of ETS, Edwards transferred the proceeds from ETS to himself or other companies he owned.

On September 11, 2000, ETS filed for bankruptcy. The bankruptcy court allowed the creation of an Official Committee of Unsecured Creditors, and the Debtors and Creditors' Committee created the ETS Creditors' Litigation Trust. The committee appointed Laddin as trustee of the debtor estate.

Laddin sued several defendants, including Reliance Trust Co., PENSCO, Inc., and Community National Bank, for (1) aiding and abetting a breach of fiduciary duties under Georgia law, (2) violations of section 1962(c) and (d) of RICO, 18 U.S.C. §§ 1962(c), (d), and (3) avoidance claims. Reliance Trust Co., PENSCO, Inc., and Community National Bank (collectively, IRA Custodians) are large holders of individual retirement accounts, and Laddin alleged that these IRA Custodians aided ETS in defrauding investors by funneling investor IRA funds into ETS payphone investments. Laddin alleged that "[b]y failing to conduct appropriate due diligence and/or ignoring the facts altogether," "[t]he IRA Custodians enabled thousands of investors to partake of the ETS scheme and caused ETS to incur millions of dollars in additional debt."

The IRA Custodians moved to dismiss Laddin's complaint. They argued that Laddin, as trustee, could not maintain a claim of aiding and abetting a breach of fiduciary duties and the doctrine of *in pari delicto*, which provides that a wrongdoer may not profit from his wrongful acts, barred Laddin's claims. The district court granted the motions to dismiss.

Before it addressed the merits of Laddin's complaint, the district court addressed Laddin's standing to sue. The district

court concluded that Laddin had standing to bring claims on behalf of the debtor, ETS, but Laddin did not have standing to assert claims on behalf of the creditors. The court reasoned that the Creditors' Committee did not have the authority to assign the claims belonging to ETS creditors and the Trust Agreement did not authorize Laddin to bring claims on behalf of creditors.

The district court also concluded that the doctrine of *in pari delicto* barred Laddin's complaint. The district court found that, under Georgia law, the wrongdoing of Edwards as a sole shareholder was imputed to ETS, the debtor corporation, under the "sole actor" rule. The court reasoned that, because the "legal and equitable interests of the debtor" in bankruptcy are only as strong as the debtor's claim against defendants at the commencement of the bankruptcy, *see* 11 U.S.C. § 541(a), the doctrine of *in pari delicto* barred Laddin's state law claims. The district court also held that the doctrine of *in pari delicto* barred Laddin's claims under RICO. Laddin appeals the dismissal by the district court.

II. STANDARD OF REVIEW

This Court reviews *de novo* the ruling of the district court on a motion to dismiss and construes the allegations in the complaint "in the light most favorable to the plaintiff." *Jackson v. BellSouth Telecomms.*, 372 F.3d 1250, 1263 (11th Cir. 2004). A motion to dismiss should not be granted unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S. Ct. 99, 101 (1957).

III. DISCUSSION

Our discussion is divided into three parts. We first address the trustee's argument that his complaint is not subject to a defense of *in pari delicto* that might have been asserted against the debtor. We then discuss whether the defense of *in*

pari delicto can be asserted against a plaintiff who asserts violations of the federal RICO statute. We finally consider whether the trustee can maintain a claim under Georgia law for aiding and abetting a breach of fiduciary duties.

A. The Trustee Is Subject to the Defenses that Were Available Against the Debtor.

The Bankruptcy Code provides that property of the debtor estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). "Legal interests or equitable interests" include any causes of action the debtor may bring. *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 356 (3d Cir. 2001). A trustee, as the representative of the estate, succeeds into the rights of the debtor-in-bankruptcy and has standing to bring any suit that the debtor corporation could have brought outside of bankruptcy. 11 U.S.C. § 323; *O'Halloran v. First Union Nat'l Bank*, 350 F.3d 1197, 1202 (11th Cir. 2003). The argument of the IRA Custodians that the wrongdoing of ETS deprives Laddin of standing to assert claims against them fails because "[a]n analysis of standing does not include an analysis of equitable defenses, such as *in pari delicto*." *R.F. Lafferty & Co.*, 267 F.3d at 347. We agree with the district court that Laddin had standing based on an alleged injury to the debtor estate, *see id.* at 346-48, but Laddin's standing to bring claims on behalf of the debtor estate does not mean that the debtor's wrongdoing is immaterial.

Laddin contends that his enforcement, as a trustee of the "legal interests or equitable interests" of the debtor estate, is not subject to the doctrine of *in pari delicto*. Laddin argues that, because the doctrine of *in pari delicto* depends on the "personal malfeasance of the individual seeking to recover," the wrongs of ETS should not be imputed to him as the bankruptcy trustee. Laddin asserts that his argument is supported by the legislative history to the Bankruptcy Code,

which explains that "[t]o the extent . . . an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate except to the extent that defenses which are personal against the debtor are not effective against the estate." 124 Cong. Rec. 32,399 (1978).

We need not resort to legislative history because the text of section 541(a) is unambiguous, and "the language of our laws is the law." *CBS, Inc. v. Primetime 24 Joint Venture*, 245 F.3d 1217, 1227 (11th Cir. 2001). Under the plain meaning of section 541(a), the debtor estate includes all "legal or equitable interests *of the debtor* as of the commencement of the case." 11 U.S.C. § 541(a) (emphasis added). "A bankruptcy trustee stands in the shoes of the debtor and has standing to bring any suit that the debtor could have instituted" when the debtor filed for bankruptcy, and there is no suggestion in the text of the Bankruptcy Code that the trustee acquires rights and interests *greater* than those of the debtor. *O'Halloran*, 350 F.3d at 1202; *see also* 11 U.S.C. § 362(a). If a claim of ETS would have been subject to the defense of *in pari delicto* at the commencement of the bankruptcy, then the same claim, when asserted by the trustee, is subject to the same affirmative defense.

Even if we considered legislative history, Laddin's argument would fail. The portion of the legislative history on which Laddin relies pertains to section 541(d), not section 541(a). Section 541(d) governs "[p]roperty in which the debtor holds . . . only legal title and not an equitable interest, such as a mortgage secured by real property . . . ." 11 U.S.C. § 541(d). The portion of the legislative history quoted by Laddin is inapplicable to the interpretation of "property of the debtor estate" under section 541(a). *See* 124 Cong. Rec. 32,399. In the law of commercial paper, personal defenses are affirmative defenses that may not be asserted against a holder-in-due-course. *See* U.C.C. § 3-305(a)(1), (2), (3) (stating that a holder-in-due-course is subject to real defenses of

duress, fraud in the factum, infancy, insolvency, and legal incapacity); *see also FDIC v. Wood*, 758 F.2d 156, 160 (6th Cir. 1985); 6 Ronald A. Anderson, Anderson on the Uniform Commercial Code § 3-305:103 (3d ed., rev. vol. 1998) ("Under the Negotiable Instruments Law that preceded the Code, the defenses were divided into real and personal defenses."). In his complaint, Laddin does not assert any rights either as a holder-in-due-course or under section 541(d). Laddin provides no support for his assertion that *in pari delicto* is a personal defense that is excluded from the debtor estate under section 541(a).

Our reading of the text of section 541(a) also comports with the purposes of the Bankruptcy Code. *See Demarest v. Manspeaker*, 498 U.S. 184, 190-91, 111 S. Ct. 599, 604 (1991) (stating that the text of the statute governs unless the result would be "so bizarre that Congress could not have intended it" (internal quotations and citations omitted)). Upon the commencement of a bankruptcy case, an automatic stay freezes the rights of parties to the bankruptcy, both debtor and creditors. 11 U.S.C. § 362(a). The automatic stay and the definition of the debtor estate "place[] both temporal and qualitative limitations on the reach of the bankruptcy estate." *Sender v. Buchanan* (*In re Hedged-Inv. Assocs.*), 84 F.3d 1281, 1285 (10th Cir. 1996); *see* 11 U.S.C. § 541. Under Laddin's erroneous interpretation of section 541, a postpetition event, the appointment of a trustee, could undermine the automatic stay and change the nature of the legal and equitable interests of the debtor estate.

Laddin argues that his recovery would ultimately inure to the benefit of innocent creditors instead of the wrongful debtor, but he fails to account for the likelihood that individual creditors damaged by the debtor's Ponzi scheme could separately pursue claims against the IRA Custodians free from the bar of *in pari delicto*. If Laddin were allowed to pursue the debtor's claims, his recovery, on the one hand,

would become part of the bankruptcy estate to be apportioned among creditors without regard to whether they were harmed by the IRA Custodians. *See* 11 U.S.C. §§ 507, 1129(b)(2) (stating that the plan of confirmation must be "fair and equitable[] with respect to each class of claims or interests"). If creditors who were harmed by the IRA Custodians, on the other hand, sued separately outside of bankruptcy, then those creditors would not risk dilution through apportionment to senior creditors or unharmed creditors of equal priority. *See id.* § 507 (prioritizing classes of claims). Creditors whose legal interests were harmed by the IRA Custodians could rightfully recover more outside of bankruptcy because they would not compete with the trustee's claims on behalf of the debtor estate.

We are not alone in concluding that the defense of *in pari delicto* may be asserted against a bankruptcy trustee. Although this is an issue of first impression in this Circuit, our sister circuits that have considered the issue have unanimously concluded that *in pari delicto* applies with equal force to a trustee-in-bankruptcy as a debtor outside of bankruptcy. *See Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 837 (8th Cir. 2005); *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 356-57 (3d Cir. 2001); *Terlecky v. Hurd (In re Dublin Sec.)*, 133 F.3d 377, 381 (6th Cir. 1997); *Sender v. Buchanan (In re Hedged-Inv. Assocs.)*, 84 F.3d 1281, 1285 (10th Cir. 1996); *see also Official Comm. of Unsecured Creditors of Color Tile v. Coopers & Lybrand, LLP*, 322 F.3d 147, 158-66 (2d Cir. 2003) (applying the defense of *in pari delicto* to bar Texas law claims brought by trustee-in-bankruptcy). Against this weight of authority, Laddin urges us to chart a new course.

Laddin erroneously relies on a decision of the Seventh Circuit and the perspective of a commentator to support his argument that *in pari delicto* does not bar recovery by a bankruptcy trustee. *See Scholes v. Lehmann*, 56 F.3d 750, 754

(7th Cir. 1995); *cf.* Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What Is § 541 Property of the Bankruptcy Estate*, 21 Emory Bankr. Dev. J. 519, 542 (2005). Laddin argues that the Seventh Circuit refused to apply *in pari delicto* to bar recovery for a receiver who brought a fraudulent conveyance action under Illinois law, *Scholes*, 56 F.3d at 754, but Laddin's appeal is governed by the Bankruptcy Code, not the law of receiverships and fraudulent conveyances under state law. *See Knauer v. Jonathon Roberts Fin. Group, Inc.*, 348 F.3d 230, 234-37 (7th Cir. 2003); *In re Hedged-Inv. Assocs.*, 84 F.3d at 185 & n.5. Fraudulent conveyances also are an exception to the general rule that the trustee takes the debtor estate as it is at the commencement of the bankruptcy. *Compare* 11 U.S.C. § 544(b) (providing that trustees may void prepetition fraudulent conveyances after the commencement of the bankruptcy) *with id.* § 541(a) (providing that the debtor estate includes "all legal or equitable interests of the debtor in the property *as of the commencement of the case*" (emphasis added)). As for Laddin's other persuasive authority, the legal commentator makes the same flawed arguments about legislative history and the *Scholes* decision that we have already rejected. *See Davis, supra* at 521-22, 538-39; *see also* Tanvir Alam, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How In Pari Delicto Has Been Perverted to Prevent Recovery for Creditors*, 77 Am. Bankr. L.J. 305 (2003).

Both the text and purposes of the Bankruptcy Code support the conclusion of the district court that Laddin's complaint is subject to the same defenses that were available against a complaint filed by the debtor at the commencement of the bankruptcy. "The equitable defense of *in pari delicto* is available in an action by a bankruptcy trustee against another party if the defense could have been raised against the debtor." *Grassmueck*, 402 F.3d at 837 (citing *R.F. Lafferty & Co., Inc.*, 267 F.3d at 355-56, 358). The next questions involve

whether the defense of *in pari delicto* would have barred recovery by the debtor, ETS, under either the federal RICO statute or Georgia law. We consider these questions in turn.

B. The Doctrine of In Pari Delicto *Bars a RICO Claim by a Conspirator.*

Laddin argues that the district court erroneously dismissed his RICO claims because the defense of *in pari delicto* is not an available defense against the debtor. Under RICO, "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter may sue . . . and shall recover threefold the damages he sustains . . . ." 18 U.S.C. § 1964(c). Section 1962(c) of RICO states, "It shall be unlawful for any person employed by or associated with any enterprise . . . to conduct or participate . . . in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt." *Id.* § 1962(c). Conspiracies in violation of section 1962(c) are also prohibited. *Id.* § 1962(d).

The doctrine of *in pari delicto* is an equitable doctrine that states "a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing." Black's Law Dictionary 794 (7th ed. 1999). This common law defense "derives from the Latin, *in pari delicto potior est conditio defendentis*: 'In a case of equal or mutual fault . . . the position of the [defending] party . . . is the better one.'" *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306, 105 S. Ct. 2622, 2626 (1985). The doctrine of *in pari delicto* is based on the policy that "courts should not lend their good offices to mediating disputes among wrongdoers" and "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality." *Id.* The issue whether this defense bars a complaint under RICO is one of first impression for our Circuit.

The federal law of affirmative defenses governs the enforcement of causes of action created by federal statutes. *See O'Melveny & Myers v. FDIC*, 512 U.S. 79, 84-85, 114 S. Ct. 2048, 2053 (1994). There is a paucity of federal caselaw regarding whether the doctrine of *in pari delicto* bars a complaint under RICO, and none of our sister circuits have squarely decided the issue. *See Roma Constr. Co. v. Arusso*, 96 F.3d 566, 570 (1st Cir. 1996) ("Whether or not there exists such an 'innocent party' requirement is a question of first impression in this circuit and, indeed, we are not aware of any cases anywhere that adopt such a requirement."); *cf. Bontkowski v. First Nat'l Bank of Cicero*, 998 F.2d 459, 462 (7th Cir. 1993) (considering whether the doctrine of *in pari delicto* barred a RICO defendant for purposes of equitable tolling).

In two cases, the Supreme Court has considered the application of the *in pari delicto* doctrine in the enforcement of antitrust and securities laws. *Bateman Eichler*, 472 U.S. 299, 105 S. Ct. 2622; *Perma Life Mufflers, Inc. v. Internat'l Parts Corp.*, 392 U.S. 134, 88 S. Ct. 1981 (1968). Although in both cases it declined to apply the doctrine of *in pari delicto*, the Court explained that this or a related doctrine might apply in other contexts. We consider each decision of the Supreme Court for guidance in resolving this issue.

At first glance, the earlier decision of the Supreme Court, *Perma Life Mufflers*, would appear to preclude the use of *in pari delicto* against a federal RICO claim because the Court held "that the doctrine of *in pari delicto*, with its complex scope, contents, and effects, is not to be recognized as a defense to an antitrust action." 392 U.S. at 140, 88 S. Ct. at 1985. The plaintiffs were franchisees who alleged that the franchisor, its parent corporation, other subsidiaries, and several individuals conspired to restrain trade and engage in illegal price discrimination. *Id.* The Court cautioned against "invoking broad common-law barriers to relief where a pri-

vate suit serves important public purposes," and in the antitrust context, the Court explained that there is an "overriding public policy in favor of competition." *Id.* at 138-39, 88 S. Ct. at 1984. "A more fastidious regard for the relative moral worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement." *Id.* That first glance does not tell the whole story, however.

The rest of the story in *Perma Life Mufflers* is that the franchisees were, in the eyes of the Court, at worst, passive violators of the antitrust laws. Because "*in pari delicto* literally means 'of equal fault,'" the Court reasoned that the doctrine should not "deny[] recovery to injured parties *merely because they have participated* to the extent of utilizing illegal arrangements formulated and carried out by others." *Id.* at 138-39, 88 S. Ct. at 1985 (emphasis added). The Court explained that the participation of the franchisees in the alleged antitrust conspiracy "was not voluntary in any meaningful sense." *Id.* at 139, 88 S. Ct. at 1985. Although the franchisees "sought the franchises enthusiastically[,] . . . they did not actively seek each and every clause of the agreement." *Id.* The franchisees "alleged that they had continually objected to [the violative terms]." *Id.* Although the Court held that *in pari delicto* did not bar the franchisees from recovery, it explicitly left open the question whether complete involvement in an antitrust violation, "wholly apart from the idea of *in pari delicto*," would bar a plaintiff from bringing an antitrust claim. *Id.* at 140, 88 S. Ct. at 1985.

The later decision of the Supreme Court in *Bateman Eichler* is much like the earlier one in *Perma Life Mufflers*, because the Court refused to apply the doctrine of *in pari delicto* to bar tippees from recovery for insider trading under federal securities laws. *Bateman Eichler*, 472 U.S. 299, 105 S. Ct. 2622. The tippees alleged that a securities broker and a company official had induced them to purchase company stock by

providing them with materially false insider information. *Id.* at 301-02, 105 S. Ct. at 2624-25. The tippees alleged that they suffered damages when the stock price fell as a result of the false information. *Id.*

As in *Perma Life Mufflers*, the holding in *Bateman Eichler* was limited, because the Court concluded that the tippees were not active participants in the alleged violation of federal law. The Court stated that, "in its classic formulation, the *in pari delicto* defense was narrowly limited to situations where the plaintiff truly bore at least substantially equal responsibility for his injury," *id.* at 306-07, 105 S. Ct. at 2627, and the Court explained that "where a plaintiff truly bore at least substantially equal responsibility for the violation, a defense based on such fault . . . s*hould be recognized.*" *Id.* at 308-09, 105 S. Ct. at 2628 (emphasis added). The Court then concluded that the face of the complaint did not reveal that the tippees had engaged in wrongdoing. *Id.* at 311 n.21, 105 S. Ct. at 2629 n.21 (stating that "the complaint does not set forth sufficient facts to conclude" that the tippees were *in delictum* because "it is uncertain whether [the tippee-plaintiffs] had any basis to believe that [the tipper-defendant] . . . had violated his fiduciary duties").

The Court explained that "there are important distinctions between the relative culpabilities of tippers, securities professionals, and tippees in these circumstances." *Id.* at 312-13, 105 S. Ct. at 2630. The Court did "not believe that the tippee properly can be characterized as being of substantially equal culpability as his tippers." *Id.* at 314, 105 S. Ct. at 2631. The Court concluded that, because the tippers in *Bateman Eichler* "masterminded this scheme to manipulate the market . . . for their own personal benefit[] and . . . used the . . . respondents as unwitting dupes," the tippees were not equally culpable. *Id.*

The Court in *Bateman Eichler* expressed its desire to advance the policy goal of the securities laws to protect "the investing public and the national economy through the pro-

motion of 'a high standard of business ethics . . . in every facet of the securities industry.'" *Id.* at 315, 105 S. Ct. at 2631 (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186–87, 84 S. Ct. 275, 280 (1963)). Because "'[t]he true insider or the broker-dealer is at the fountainhead of the confidential information[,] . . . the most effective means . . . is to nip in the bud the source of the information'" and allow tippees to recover from the fraudulent tippers. *Id.* at 316, 105 S. Ct. at 2632 (quoting *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F. Supp. 50, 57-58 (S.D.N.Y. 1971)). For that reason, the Court explained that a tippee's complaint should be barred "only where (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public." *Id.* at 310-11, 105 S. Ct. at 2629.

Under *Perma Life Mufflers* and *Bateman Eichler*, the application of the defense of *in pari delicto* to causes of action created by federal statutes depends on two factors: (1) the plaintiffs' active participation in the violation *vel non* and (2) the policy goals of the federal statute. *See Pinter v. Dahl*, 486 U.S. 622, 632–33, 108 S. Ct. 2063, 2071 (1988). Both of these factors support the application of the *in pari delicto* doctrine in this appeal. We consider each factor in turn.

First, it is beyond doubt that the allegations of the trustee's complaint render ETS in active participation with the IRA Custodians. If anything, the conduct of ETS was *in majore delicto*. Laddin alleged that "ETS devised the scheme and promoted and marketed the sale and leaseback of payphones as investment opportunities to individuals." ETS also "control[led] all aspects of the operation," "created marketing and promotional materials," and "promised returns . . . of 14% or 15%" although it "assumed a liability it could not satisfy." Although the IRA Custodians allegedly "enabled thousands

of investors to partake of the ETS scheme and caused ETS to incur millions of dollars in additional debt," ETS "devised the scheme," transferred funds from IRA accounts, and "with the sale of each phone, [] assumed a liability it could not satisfy."

On appeal, Laddin fails to explain how the IRA Custodians violated RICO while ETS was a passive bystander in their scheme to defraud. Laddin's complaint alleged that ETS was the hub of the Ponzi scheme to defraud investors. The allegations in the complaint logically compel the conclusion that ETS had "substantially equal responsibility for [its] injury." *Bateman Eichler*, 472 U.S. at 308-09, 105 S. Ct. at 2628.

Second, the application of *in pari delicto* to bar Laddin's complaint advances the policy of civil liability under the federal RICO statute. Laddin argues that plaintiffs should be allowed to recover to serve the deterrent purposes underlying the civil liability provision of RICO regardless of whether the plaintiffs participated in the wrongdoing. We disagree. Under RICO, "[i]t shall be unlawful for *any person* employed by or associated with *any enterprise* . . . to conduct or participate . . . in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt." 18 U.S.C. § 1962(c) (emphasis added). It would be anomalous, to say the least, for the RICO statute to make racketeering unlawful in one provision, yet award the violator with treble damages in another provision of the same statute. "Congress intended RICO's civil remedies to help eradicate 'organized crime from the social fabric' by divesting 'the association of the fruits of ill-gotten gains.'" *Genty v. Resolution Trust Corp.*, 937 F.2d 899, 910 (3d Cir. 1991) (quoting *United States v. Turkette*, 452 U.S. 576, 585, 101 S. Ct. 2524, 2529 (1981)). Laddin's recovery under RICO would not divest RICO violators of their ill-gotten gains; it would result in a wealth transfer among similarly situated conspirators.

Laddin argues that some district courts and bankruptcy courts have held that the doctrine of *in pari delicto* is not an available defense in federal RICO actions because the public policy objectives of RICO are similar to those of the antitrust laws, but Laddin's reliance on these decisions is misplaced. *See, e.g., Harper v. AT&T*, 54 F. Supp. 2d 1371 (S.D. Ga. 1999); *Bieter Co. v. Blomquist*, 848 F. Supp. 1446 (D. Minn. 1994); *In re Nat'l Mortgage Equity Corp.*, 636 F. Supp. 1138 (C.D. Cal. 1986). These courts have relied on *Perma Life Mufflers* to conclude that the punitive and deterrent aspects of antitrust treble damages are equally applicable in the racketeering context, *In re Nat'l Mortgage Equity Corp.*, 636 F. Supp. at 1156 (stating that the reasoning in *Perma Life Mufflers* is "equally applicable to RICO treble damage actions"), but they misinterpret the holding of *Perma Life Mufflers.* Because federal RICO violations, as a matter of law, require affirmative wrongdoing rather than passive acquiescence, *Perma Life Mufflers* does not preclude the defense of *in pari delicto* in the RICO context.

The Court in *Perma Life Mufflers* premised its holding on the passive characteristics of antitrust participants. In that context, "participation [i]s not voluntary in any meaningful sense" when antitrust violators do not "seek each and every clause of the agreement," but must accept questionably violative terms to obtain an otherwise attractive business opportunity. *Perma Life Mufflers*, 392 U.S. at 139, 88 S. Ct. 1985. *Perma Life Mufflers* explicitly left open the possibility that a defense of active involvement could bar a complaint about an antitrust conspiracy, and our sister circuits have accordingly barred antitrust claims where the plaintiff was completely involved in the antitrust conspiracy. *See THI-Hawaii, Inc. v. First Commerce Fin. Corp.*, 627 F.2d 991, 995 (9th Cir. 1980) (holding that there is "complete involvement" where "the illegal conspiracy would not have been formed but for [the plaintiff's] participation" and barring recovery by a plaintiff who negotiated, prepared, and earned

revenues from an exclusive sales agreement with the defendant); *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3, 15-16 (4th Cir. 1971) ("[W]hen parties of substantially equal economic strength mutually participate in the formulation and execution of the scheme and bear equal responsibility for the consequent restraint of trade, each is barred from seeking treble damages from the other."); *cf. Premier Elec. Constr. Co. v. Miller-Davis Co.*, 422 F.2d 1132, 1138 (7th Cir. 1970) ("[W]e believe that *Perma Life* holds only that plaintiffs who do not bear equal responsibility for creating and establishing an illegal scheme, or who are required by economic pressures to accept such an agreement, should not be barred from recovery simply because they are participants.").

In contrast with antitrust violations, a federal RICO violation requires affirmative and deliberate participation. A violation of RICO requires that the defendants "participated, either directly or indirectly, in the conduct of the affairs of the enterprise . . . through a pattern of racketeering activity." *United States v. Starrett*, 55 F.3d 1525, 1541 (11th Cir. 1995); 18 U.S.C. § 1962(c). A "'pattern of racketeering activity' requires at least *two acts* of racketeering activity." 18 U.S.C. § 1961(5) (emphasis added); *see id.* § 1961(1) (defining "racketeering" as "any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery," etc.). The defendant also must "knowingly implement[]" and "mak[e]" decisions. *Starrett*, 55 F.3d at 1548; *see Reves v. Ernst & Young*, 507 U.S. 170, 185, 113 S. Ct. 1163, 1173 (1983) (holding that the defendant "participates" if he "directs" the pattern of racketeering activity).

Because a complaint brought by ETS, outside of bankruptcy, against other members of its RICO conspiracy would have been barred by the doctrine of *in pari delicto*, Laddin is likewise barred from recovery within bankruptcy. Laddin's complaint is barred because ETS was an active participant in

the Ponzi scheme and the application of the defense of *in pari delicto* furthers the policy of the federal RICO statute. The district court did not err when it dismissed Laddin's claim for treble damages under the federal RICO statute, because his recovery was barred based on the face of his complaint.

C. Georgia Does Not Recognize a Claim for Aiding and Abetting a Breach of Fiduciary Duties.

Laddin contends that the doctrine of *in pari delicto* does not bar his claims for aiding and abetting a breach of fiduciary duties. We need not reach this issue because we previously have held that Georgia courts have not recognized a cause of action for aiding and abetting a breach of fiduciary duties. *Munford v. Valuation Research Corp.*, 98 F.3d 604, 613 (11th Cir. 1996); *see also Monroe v. Bd. of Regents of Univ. Sys. of Ga.*, 602 S.E.2d 219, 224 (Ga. Ct. App. 2004) ("Georgia has never recognized a claim for aiding and abetting a breach of fiduciary duty."). "[W]e may affirm for any reason supported by the record, even if not relied on by the district court." *Cochran v. U.S. Health Care Fin. Admin.*, 290 F.3d 775, 778 n.3 (11th Cir. 2002). "Even assuming that Georgia courts will someday recognize a cause of action for aider and abettor liability in the context of a breach of fiduciary claim, the facts in this case do not warrant its creation now." *Munford*, 98 F.3d at 613. Because the bankruptcy trustee may only "bring any suit that the debtor could have instituted had it not been thrown into bankruptcy," *O'Halloran*, 350 F.3d at 1202, the district court correctly dismissed Laddin's claim for aiding and abetting a fiduciary duty.

IV. CONCLUSION

The dismissal of Laddin's complaint for federal RICO violations and aiding and abetting a breach of fiduciary duties under Georgia law is

AFFIRMED.

(2)

No. 05-1335

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SUPREME COURT, U.S.

In The
Supreme Court of the United States

Trustee DARRYL S. LADDIN of the
ETS Creditors' Litigation Trust,

Petitioner,

v.

RELIANCE TRUST COMPANY, PENSCO, INC.,
JOHN PROKOP, and COMMUNITY NATIONAL BANK,

Respondents.

**On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eleventh Circuit**

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Eleventh Circuit Court of Appeals ruling that the defense of *in pari delicto* is applicable against a bankruptcy trustee who has succeeded to the interests of a debtor pursuant to 11 U.S.C. § 541(a) warrants review by this Court.

2. Whether the Eleventh Circuit Court of Appeals ruling that the defense of *in pari delicto* is applicable to causes of action arising under the federal Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. § 1961, *et seq.*, warrants review by this Court.

PARTIES

The caption of the Petitioner's Petition contains the names of all the remaining interested parties to this action.

CORPORATE DISCLOSURE STATEMENT

Community National Bank is a wholly owned subsidiary of Community Bancshares, Inc.

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PRIOR CITATIONS AND REPORTS

The Order of the United States District Court for the Northern District of Georgia is not reported. The Eleventh Circuit Court of Appeals decision is reported at 437 F. 3d 1145 (11th Cir. 2006).

STATEMENT OF JURISDICTION

The Order of the Eleventh Circuit Court of Appeals was entered on January 30, 2006. Petitioner filed his Petition for Writ of Certiorari on April 14, 2006. This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 1254, as a timely appeal of a final decision of a United States Court of Appeals.

STATUTORY PROVISIONS AT ISSUE

1. Federal Racketeer Influence and Corrupt Organizations Act. 18 U.S.C. § 1961 *et seq.*

2. United States Bankruptcy Code. 11 U.S.C. § 541(a).

STATEMENT OF THE CASE

According to the Trustee's Complaint in this matter, in approximately October of 1994, Charles Edwards ("Edwards") formed ETS Payphones, Inc. ("ETS"). (R8-127-17) Trustee's Complaint further alleges, "[w]ith Edwards at its helm, ETS devised the scheme and promoted and marketed the sale and leaseback of payphones as investment opportunities to individuals." (R8-127-18) ETS was in the

business of selling pay coin operated telephones and leasing them back from the customers for a stated amount. (R8-127-17) Edwards, the CEO, founder, and sole shareholder of ETS developed the sale and leaseback business plan. (R8-127-18) According to the Third Amended Complaint, "this business plan was fundamentally flawed from the outset and constituted a fraud on the thousands of investors who entrusted their nest eggs to Edwards." (R8-127-18) The operation of the sale-leaseback program was a Ponzi scheme that defrauded thousands of investors of over $300 million. As the sole shareholder of ETS, Edwards transferred the proceeds from ETS to himself or other companies he owned.

On September 11, 2000, ETS filed for bankruptcy. The bankruptcy court allowed the creation of an Official Committee of Unsecured Creditors, and the Debtors and Creditors' Committee created the ETS Creditors' Litigation Trust. The committee appointed Laddin as trustee of the debtor estate.

Laddin sued several defendants, including Reliance Trust Co., PENSCO, Inc., and Community National Bank, ("IRA Custodians") for among other claims, violations of section 1962(c) and (d) of RICO, 18 U.S.C. §§ 1962(c) and (d). Laddin alleged that these IRA Custodians aided ETS in defrauding investors by funneling investor IRA funds into ETS payphone investments.

The IRA Custodians moved to dismiss Laddin's complaint. They argued Laddin, as trustee, could not maintain his claims based, inter alia, on the doctrine of *in pari delicto*. The district court granted the motions to dismiss and the Eleventh Circuit Court of Appeals affirmed the dismissal.

SUMMARY OF THE ARGUMENT

The Petitioner Trustee, who stands in the shoes of ETS, cannot assert claims that ETS could not have asserted. The Trustee's authority to bring this lawsuit are limited by the clear language of 11 U.S.C. § 541, and are derived, if at all, from the rights he obtained through the Litigation Trust Agreement. As such, the Eleventh Circuit Court of Appeals was correct in ruling the defense of *in pari delicto* is applicable against a bankruptcy trustee who has succeeded to the interests of a debtor pursuant to 11 U.S.C. § 541(a). This ruling is consistent with all the circuit courts that have considered such issue.

Additionally, based on the plain language of 11 U.S.C. § 541(a), the Eleventh Circuit Court of Appeals did not need to consider the legislative history of Section 541 in determining the defense of *in pari delicto* barred the Trustee's claims. Further, the Court of Appeals was correct in finding that even considering the legislative history of Section 541, the defense of *in pari delicto* would still bar the Trustee's claims. The Trustee misconstrued the legislative history of Section 541 and the portion cited by the Trustee is inapplicable to the issues before this Court.

Moreover, the Court of Appeals was correct in finding the defense of *in pari delicto* is applicable to causes of action arising under the federal Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. § 1961, *et seq.*, because RICO violations necessarily require affirmative wrongdoing, such as engaged in by ETS in this instance.

ARGUMENT AND CITATIONS OF AUTHORITY

I. The Court of Appeals was correct in ruling the Trustee's claims against the IRA Custodians are barred by the *in pari delicto defense* and such ruling is consistent with the ruling of every other Circuit Court that has considered the issue and does not merit review by this Court

In their briefs before the District Court and the Eleventh Circuit Court of Appeals, Community National Bank and the other IRA Custodians cited numerous cases wherein the complaints of trustees or creditors' committees against third-parties for their alleged role in aiding or abetting the sole shareholder(s) of a corporation involved in a Ponzi scheme were dismissed based on the doctrine of *in pari delicto*.[1]

Conversely, the Trustee has not identified a single case on point where the court ruled in favor of the Trustee's position and found the *in pari delicto* defense was inapplicable to bankruptcy trustees in such instances. Rather, the Trustee relies instead on commentators who, while acknowledging that the law is as the Court of Appeals determined, none the less advocates a change in the law to preclude the application of the *in pari delicto*

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[1] *See, e.g., In re The Mediators Inc.*, 105 F.3d 822 (2nd Cir. 1997); *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085 (2nd Cir. 1995); *E.F. Hutton & Co. v. Hadley*, 901 F.2d 979 (11th Cir. 1990); *Shearson Lehman Hutton Inc. v. Wagoner*, 944 F.2d 114 (2nd Cir. 1991); *F.D.I.C. v. Ernst & Young*, 967 F.2d 166 (5th Cir. 1992); *In re The Mediators Inc.*, 190 B.R. 515 (S.D.N.Y. 1995); *In re Complete Management Inc.*, 2003 WL 21750178 (S.D.N.Y. 2003); *Lippe v. Bairnco Corp.*, 218 B.R. 294 (S.D.N.Y. 1998); *In re Meridian Asset Mgmt. Inc.*, 296 B.R. 243 (N.D. Fla. 2003); *Brown v. Deloitte & Touche LLP*, 1999 WL 269901 (S.D.N.Y. 1999); *Official Committee of Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand LLP*, 322 F.3d 147 (2nd Cir. 2003).

defense to bankruptcy trustees. In fact, the Trustee admits in his Petition "the Eleventh Circuit here, *and indeed all of the Circuit Courts that have addressed the question to date . . .* " have determined the defense of *in pari delicto* is applicable to a bankruptcy trustee in this circumstance. (Petitioner's Petition for Writ of Cert., pg. 8).

Moreover, in an attempt to bring this case under the guise of review by this Court, the Trustee asserts "The Eleventh Circuit's 'ruling' that Section 541 is so 'unambiguous' as to *prohibit* consideration of its legislative history creates a split in the Circuits, and a departure from prior rulings by this Court, on that issue." (emphasis added) (Petitioner's Petition for Writ of Cert., pg. 12).

Contrary to the Trustee's assertions, the Eleventh Circuit did not issue a "ruling" or holding "prohibiting" consideration of the legislative history of Section 541(a). Rather, the Eleventh Circuit merely stated in its analysis of the applicability of the *in pari delicto* defense under Section 541(a) that it "need not resort to legislative history" due to the "unambiguous" language of Section 541(a) with regard to the particular issue before it. *Laddin v. Edwards,* 437 F.3d 1145, 1150 (11th Cir. 2006). In fact, the Eleventh Circuit did consider the legislative history of Section 541(a) and undertook a rather detailed analysis of such history and reached the same conclusion it reached based on its analysis of the language of the statute itself, a conclusion the Trustee readily admits has been reached by every other circuit court that has considered the issue.

Further, the Trustee seeks review by this Court of the Eleventh Circuit's decision based on "equitable principles" in the bankruptcy code not considered by the Court. The Trustee argues the Eleventh Circuit, in issuing its ruling,

"refused to consider the post-petition removal of the wrongdoer (Edwards) and appointment of an innocent party (the Trustee) seeking recovery for the benefit of innocent investors and other creditors." The Trustee again mischaracterizes the Eleventh Circuit's Opinion in his attempt to gain review by this Court.

Contrary to the Trustee's assertions, the Eleventh Circuit specifically addressed the "equitable principles" espoused by the Trustee in his Petition. The Eleventh Circuit specifically stated in its Opinion:

> Laddin argues that his recovery would ultimately inure to the benefit of innocent creditors instead of the wrongful debtor, but he fails to account for the likelihood that individual creditors damaged by the debtor's Ponzi scheme could separately pursue claims against the IRA Custodians free from the bar of in pari delicto.

Id. at 1151. The mere fact the Trustee may not like or agree with the Eleventh Circuit's ruling regarding this matter is an insufficient basis to seek review of that ruling by this Court. The Eleventh Circuit was correct in both its analysis, and its conclusions, regarding the issues before it in this case and there is no split in the Circuits regarding any issues that were before it that merit review by this Court.

II. The Court of Appeals was correct in ruling the defense of *in pari delicto* is applicable to causes of action by a conspirator arising under the federal Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. § 1961, *et seq.* and such ruling does not merit review by this Court.

The Trustee asserts the ruling by the Eleventh Circuit that the defense of *in pari delicto* bars the Trustee's claims against Commercial National Bank and the IRA Custodians is contrary to the rulings of "numerous" other federal courts and as such, should be reviewed by this Court. Contrary to Trustee's assertion however, federal case law regarding this issue is scarce, and no other circuit court has directly determined this issue.

This Court has however, as stated by the Eleventh Circuit in its Opinion, considered the issue of the application of the *in pari delicto* defense in the context of federal antitrust and securities regulations. *Bateman Eichler v. Berner*, 472 U.S. 299, 105 S. Ct. 2622, 86 L. Ed. 2d 215; *Perma Life Mufflers, Inc. v. Internat'l Parts Corp.*, 392 U.S. 134, 88 S. Ct. 1981, 20 L. Ed. 2d 982 (1968). As admitted by the Trustee in his Petition, federal law governs the applicability of affirmative defenses, such as *in pari delicto*, to causes of action created by federal law. *See O'Melveny & Myers v. FDIC*, 512 U.S. 79, 84-85, 114 S. Ct. 2048, 2053, 129 L. Ed. 2d 67 (1994).

As pointed out by the Eleventh Circuit, pursuant to the *Perma Life Mufflers* and *Bateman Eichler* Opinions, the application of the *in pari delicto* defense to federal causes of action, including RICO, depends on two factors: (1) the plaintiffs' active participation in the violation vel non and (2) the policy goals of the federal statute. *Laddin v. Edwards*, 437 F.3d at 1154. In his Petition, Trustee does not take issue with the Eleventh Circuit's pronouncement of these factors. Rather, the Trustee asserted the Eleventh

Circuit "drew ill-founded distinctions" between this case and the *Perma Life Mufflers* and *Bateman Eichler* cases, and misapplied this Court's rulings in those cases under the context of the RICO act.

While Community National Bank strongly disagrees that the Eleventh Circuit misapplied the factors set forth by this Court in *Perma Life Mufflers* and *Bateman Eichler*, the misapplication of these factors by the Eleventh Circuit, even if such did occur, is not a sufficient basis for review of the Eleventh Circuit's Opinion by this Court. United States Supreme Court Rule 10 specifically states, "A petition for writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings *or the misapplication of a properly stated rule of law.*" Thus, while review on a write of certiorari is discretionary, the assertions by Trustee in his Petition do not allege a basis for which this Court has historically granted review and the Trustee's Petition should be denied.

CONCLUSION

For all of the reasons set forth herein, Respondent Community National Bank prays that Petitioner Trustee's Petition for Writ of Certiorari be denied.

Respectfully submitted,

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No. 05-1335

IN THE

Supreme Court of the United States

DARRYL S. LADDIN,
as Trustee of the ETS Creditors' Litigation Trust,

Petitioner,

v.

RELIANCE TRUST COMPANY, PENSCO, INC.,
and COMMUNITY NATIONAL BANK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENTS RELIANCE TRUST COMPANY AND PENSCO, INC.

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QUESTIONS PRESENTED FOR REVIEW

Petitioner's questions mischaracterize the issues that were actually before the Eleventh Circuit. If anything, the only question presented by this record is whether a bankruptcy trustee can assert claims against a third party on behalf of a debtor when the allegations in his complaint demonstrate that the debtor itself actively participated in the alleged conduct on which the claims are based and, thus, the debtor could not have brought the claims outside of bankruptcy. However, all of the Circuits that have addressed the issues raised below, specifically, the Second, Fourth, Sixth, Eighth, Tenth, and Eleventh Circuits, have uniformly answered the question in the negative.

CORPORATE DISCLOSURE STATEMENT

Reliance Trust Company is a wholly-owned subsidiary of Reliance Financial Corporation. PENSCO, Inc., does not have a parent company and no publicly held company owns 10% or more of PENSCO, Inc.'s stock.

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INTRODUCTION

Simply stated, Petitioner is asking this Court to ignore the clear meaning of applicable statutory law to overturn the decisions of the Second, Fourth, Sixth, Eighth, Tenth, and Eleventh Circuits and adopt the position advocated by some legal commentators who wish that the law were different than it is. If anything, the only question presented by this record is whether a bankruptcy trustee can assert claims against a third party on behalf of a debtor when the allegations in his complaint demonstrate that the debtor itself actively participated in the alleged conduct on which the claims are based and, thus, could not have brought the claims outside of bankruptcy.

Consistent with the decisions of every Court of Appeals that has looked at the issues raised below, the Eleventh Circuit rejected Petitioner's attempt to assert claims on behalf of a debtor that the debtor itself could not have asserted. Petitioner has not and cannot demonstrate that the Eleventh Circuit's January 30, 2006, Opinion (the "Opinion") is in conflict with any decision of this Court or another Court of Appeals, or that the Eleventh Circuit decided an important federal question that has not been addressed by this Court. In fact, Petitioner acknowledges, as the Eleventh Circuit did in its Opinion, that *all* of the Courts of Appeals that have addressed the issues discussed therein have uniformly held that the *in pari delicto* defense bars a bankruptcy trustee from asserting the kinds of claims that Petitioner is trying to assert against the Respondents.

Even if this Court were inclined to engage in the judicial legislation that Petitioner is inviting, the result in this case should be the same because Petitioner's own pleadings set

forth such a clear case of *in pari delicto* on the part of the debtor whose claims Petitioner is purportedly trying to assert in this case. In other words, this is a case where the specific factual allegations pled by Petitioner and relied upon by the lower courts were determinative of the outcome. Finally, because the Private Securities Litigation Reform Act provides an additional and alternative basis for affirming the lower court's decision, review by this Court is unwarranted.

RESPONSE TO PETITIONER'S STATEMENT OF THE CASE

The Eleventh Circuit Court's Opinion, reproduced in the Appendix to the Petition for *Writ of Certiorari* (the "Petition"), contains most of the relevant facts, which are taken from Petitioner's Third Amended Complaint itself. For the most part, the Respondents agree that the Petitioner's "Statement of the Case" provides an accurate synopsis of the relevant facts and an accurate summary of the decisions of the courts below. Rather than repeat each element of Petitioner's Statement of the Case, the Respondents will instead address areas of disagreement and clarification below.

Petitioner is the trustee of the ETS Creditors' Litigation Trust, which was created by the Debtors and Creditors Committee in the course of the bankruptcy of ETS Payphones, Inc. ("ETS"). As trustee, Petitioner sued more than forty-one (41) defendants on various legal theories over the course of several years in several amended complaints. As to the Respondent IRA Custodians, the Third Amended Complaint alleged counts for Aiding and Abetting Breach of Fiduciary Duty to the Debtor (Count I), Aiding and Abetting Breach of Fiduciary Duty to Creditors (Count II), and RICO violations (Counts XI, XII, and XIII). More importantly, as

the Eleventh Circuit noted, the allegations of Petitioner's Third Amended Complaint (which are considered to be true for purposes of Respondents' Motion to Dismiss) establish that ETS was in active participation with the Respondents. Petitioner's Appendix at 26a. Petitioner alleged that "ETS [the debtor] devised the scheme and promoted and marketed the sale and leaseback of payphones as investment opportunities to individuals." *Id.* ETS also "control[led] all aspects of the operation," "created marketing and promotional materials," and "promised returns . . . of 14% or 15%," although it "assumed a liability it could not satisfy." *Id.* "Although the Respondents allegedly 'enabled thousands of investors to partake of the ETS scheme and caused ETS to incur millions of dollars in additional debt,' ETS 'devised the scheme,' transferred funds from IRA accounts, and 'with the sale of each phone, [] assumed a liability it could not satisfy.'" *Id.* at 26a-27a.

Based on the allegations in the Third Amended Complaint, Respondents moved to dismiss all Counts, and the District Court granted their motions on all Counts. Petitioner did not appeal the dismissal of Count II to the Eleventh Circuit. The Eleventh Circuit then affirmed the grant of dismissal as to the remaining Counts. Petitioner has not sought review of the Eleventh Circuit's affirmance of the dismissal of Count I (aiding and abetting breach of fiduciary duty to the Debtor), which was based on the Eleventh Circuit's finding that Georgia law does not recognize such a claim. Thus, this Petition is focused solely on the RICO claims brought by Petitioner against the Respondent IRA Custodians. In accordance with the Eleventh Circuit's Opinion and the decisions of the Second, Fourth, Sixth, Eighth and Tenth Circuits, these claims must fail and this Petition should be denied.

REASONS FOR DENYING THE PETITION

Petitioner is desperately trying to posture this as a case that requires intervention from this Court. However, the law is already clear and uniform that, under the facts alleged by the Petitioner, he is barred by the doctrine of *in pari delicto* from bringing the claims he alleged against the Respondents. The well reasoned opinions of the Eleventh Circuit and the District Court are grounded in sound legal principles and the specific "facts" taken from Petitioner's own Third Amended Complaint. Notwithstanding the harmony between these opinions and the opinions of every federal Court of Appeals that has addressed these issues, Petitioner begins his argument by claiming that this case presents the Court with the "opportunity" to issue the "definitive ruling" on an issue of "first impression"[1] and to "correct" the "consistently unjust and ill founded rulings issued by the Eleventh Circuit here, and all of the Circuits that have addressed the question to date." Because the legal points have been uniformly addressed by this Court and the Courts of Appeals, this Court should pass on this "opportunity" to rewrite the law and instead deny the Petition.

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1. In its Opinion, the Eleventh Circuit, in holding that *in pari delicto* can be asserted against a bankruptcy trustee, noted that "[a]lthough this is an issue of first impression in this Circuit, our sister circuits that have considered the issue have unanimously concluded that *in pari delicto* applies with equal force to a trustee-in-bankruptcy as a debtor outside bankruptcy." Petitioner's Appendix at 20a.

I. All of the Courts of Appeals That Have Addressed These Issues in Factually Similar Cases Have Uniformly and Unanimously Concluded That *In Pari Delicto* Applies to a Bankruptcy Trustee and That It Bars a Bankruptcy Trustee from Bringing the Types of Claims That Petitioner Is Trying to Bring against the Respondents.

Petitioner acknowledges throughout his Petition that all of the Courts of Appeals confronted with these issues have uniformly applied the defense of *in pari delicto* to bar a trustee's claims against third parties where the facts demonstrate that the debtor itself could not have brought the claims. In fact, six federal Courts of Appeals have now addressed this defense in the context of a bankruptcy trustee and unanimously applied the defense of *in pari delicto* to bar a bankruptcy trustee from bringing such claims. *See Official Comm. of Unsecured Creditors of Color Tile v. Coopers & Lybrand, LLP*, 322 F.3d 147, 158-166 (2d Cir. 2003); *see also Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 356-357 (3d Cir. 2001); *Terlecky v. Hurd (In re Dublin Secs., Inc.)*, 133 F.3d 377, 381 (6th Cir. 1997); *Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 837 (8th Cir. 2005); *Sender v. Buchanan (In re Hedged-Inv. Assocs., Inc.)*, 84 F.3d 1281, 1285 (10th Cir. 1996); *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards (In re PSA, Inc.)*, 437 F.3d 1145, 1150 (11th Cir. 2006). While on the one hand acknowledging this uniformity in the law, Petitioner is on the other hand asking this Court to overturn all of these decisions in favor of an argument advocated by a small group of academics based on an inapplicable sentence taken from the legislative history of Section 541(d)[2] of the Bankruptcy

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2. As the Eleventh Circuit noted, "[t]he portion of the legislative history on which [Petitioner] relies pertains to section 541(d), not (Cont'd)

Code. The Northern District of Georgia and the Eleventh Circuit, in addressing the arguments raised by Petitioner, properly declined Petitioner's invitation to change the law. This Court should do the same and deny the Petition. Additionally and alternatively, this Petition should be denied because the Private Securities Litigation Reform Act specifically amended the Federal RICO Act to bar the claims that Petitioner has tried to bring in this case.

A. There Is No Split in Authority Regarding the Application of *In Pari Delicto* to a Bankruptcy Trustee.

Although Petitioner would like to find some authority contrary to the six Circuits that have already addressed this issue, the law is clear and uniform that the defense of *in pari delicto* can and should apply to a bankruptcy trustee when the complaint alleges that the debtor was an active participant in the alleged violation of law. The doctrine of *in pari delicto* is an equitable doctrine that states that "a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing." Black's Law Dictionary 794 (7th ed. 1999).

In hopes of convincing this Court to rewrite the law, Petitioner argues several propositions, all of which lack legal support and are in fact contrary to the well-settled law in

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(Cont'd)

section 541(a). Section 541(d) governs '[p]roperty in which the debtor holds . . . only legal title and not an equitable interest, such as a mortgage secured by real property. . . .'" Petitioner's Appendix at 18a. "The portion of the legislative history quoted by [Petitioner] is inapplicable to the interpretation of 'property of the debtor estate' under section 541(a). *Id.*

this area. For instance, Petitioner has asked the Eleventh Circuit and this Court to find (a) that a trustee is not subject to the so-called "personal defenses" to which a debtor would otherwise be subject, and (b) that *in pari delicto* is one of these so-called "personal defenses." However, as the Eleventh Circuit noted, Petitioner has offered no law to support this position. ("Laddin provides no support for his assertion that *in pari delicto* is a personal defense that is excluded from the debtor estate under section 541(a)."). Petitioner's Appendix at 19a. Instead of legal support, Petitioner cites to a few academic articles and references one Southern District of Florida Bankruptcy Court opinion[3] that relied expressly on one of the academic articles. However, each of these commentators acknowledges that the law is contrary to his position and each advocates for a change in the law. This is not the proper forum to request a change in the law of bankruptcy.[4]

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3. In its Opinion below, the Eleventh Circuit expressly rejected the argument relied upon by the Judge in *Tolz v. Proskauer Rose LLP (In re Fuzion Tech. Group, Inc.)*, 332 B.R. 225 (Bankr. S.D. Fla. 2005). The court in *In re Fuzion* adopted the argument advocated by one of the commentators cited by Petitioner. *See* Petitioner's Appendix at 21a. Having now issued a definitive ruling, which is in accord with the decisions of all of the other Courts of Appeals that have addressed theses issues, the Eleventh Circuit has dealt with and rejected the arguments raised in the articles relied upon in this single, non-precedential, aberrant decision. Based on the Opinion below, the law in the Eleventh Circuit is clear that *in pari delicto* can bar a trustee from bringing claims under the facts alleged by Petitioner.

4. It is notable that when Congress overhauled the Bankruptcy Code in 2005, it did not take the opportunity to address the numerous uniform decisions of the Courts of Appeals that had applied *in pari delicto* to bar a trustee's claims.

B. There Is No Split in the Circuits Regarding the Interpretation of Section 541 of the Bankruptcy Code or Its Legislative History.

Petitioner desperately wants this Court to adopt a position advocated by a legal commentator who has argued that an inapplicable and almost universally ignored sentence from the legislative history of Section 541(d) of the Bankruptcy Code should be extrapolated and applied to interpret Section 541(a) so as to avoid the application of *in pari delicto* to bankruptcy trustees. This position is contrary to the opinions offered by, *inter alia*, all six of the Courts of Appeals that have addressed these issues. Contrary to Petitioner's unsupported argument, there is no split in authority regarding the interpretation of Section 541(a) of the Bankruptcy Code, which defines the debtor's estate.

Petitioner argued below that he should be able to bring claims that ETS could not have brought because, in his opinion, as trustee, he should not be subject to the same defenses, such as *in pari delicto*, to which ETS would have been subject if it brought the same claims outside of bankruptcy. However, Section 541(a) of the Bankruptcy Code provides that property of the debtor estate includes "all legal or equitable interests of the debtor in property *as of the commencement of the case*." (Emphasis added). In its Opinion below affirming the dismissal of Petitioner's claims, the Eleventh Circuit rejected Petitioner's argument and noted that it did not need to resort to the legislative history of Section 541(a) to understand Section 541(a) because the text of Section 541(a) is unambiguous, and that "the language of our laws is the law." *See* Petitioner's Appendix at 18a, *citing CBS Inc. v. Primetime 24 Joint Venture*, 245 F.3d 1217, 1227 (11th Cir. 2001).

The Eleventh Circuit continued that, "[u]nder the plain meaning of section 541(a), the debtor estate includes all legal or equitable interest *of the debtor* as of the commencement of the case. 11 U.S.C. § 541(a)." Petitioner's Appendix at 18a (emphasis in original).

> 'A bankruptcy trustee stands in the shoes of the debtor and has standing to bring any suit that the debtor could have instituted' when the debtor filed for bankruptcy, and there is no suggestion in the text of the Bankruptcy Code that the trustee acquires rights and interests *greater* than those of the debtor.

Id. "If a claim of ETS would have been subject to the defense of *in pari delicto* at the commencement of the bankruptcy, then the same claim, when asserted by the trustee, is subject to the same affirmative defense." *Id.*

Petitioner disagrees with the conclusion reached by the Eleventh Circuit (and all of the other Circuits that have addressed this issue). In hopes of inviting review by this Court, Petitioner mischaracterizes the Opinion of the Eleventh Circuit in order to try to create a controversy where there is none. Specifically, Petitioner claims that the Eleventh Circuit's Opinion somehow "conflicts" with some other courts that have reached the same conclusion as the Eleventh Circuit but have looked to the legislative history of Section 541 to do so. However, even if this illusory conflict did exist and the Eleventh Circuit were asked to look beyond the clear language of Section 541(a), the result would have been the same. Contrary to Petitioner's position, the Eleventh Circuit stated that "[e]ven if we considered legislative history, Laddin's argument would fail." Petitioner's Appendix at 18a.

The Court analyzed Petitioner's argument, which is drawn from the legal commentators who want courts to look to an inapplicable and properly ignored (in interpreting Section 541(a)) sentence of the legislative history of Section 541(d). In rejecting Petitioner's argument, the Eleventh Circuit expressly noted that "the legal commentators make the same flawed arguments about legislative history and the *Scholes*[5] decision that we have already rejected [earlier in our opinion]." *Id.* at 21a.

Petitioner is now inviting this Court to engage in the same wild goose chase in which the Eleventh Circuit refused to participate even though Petitioner had pointed out that the argument had been adopted by one solitary bankruptcy court in Florida[6] faced with easily distinguishable facts. The language of Section 541 is clear and the cases interpreting it are legion. There is no conflict in the authority and, in fact, no contrary authority adopting Petitioner's argument regarding the legislative history of Section 541.

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5. *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995), was a case involving a receiver, not a bankruptcy trustee. Petitioner argues that the reasoning from *Scholes* should apply to a bankruptcy trustee despite the fact that receivers are not subject to the limitations of Section 541(a). It is noteworthy that the Seventh Circuit later narrowed *Scholes* to situations involving fraudulent transfers, which are not even at issue in this case with respect to the Respondents. *See Knauer v. Jonathon Roberts Fin. Group, Inc.*, 348 F.3d 230 (7th Cir. 2003).

6. Unlike the instant case, in *In re Fuzion*, there were multiple shareholders (Edwards was the sole shareholder of ETS) and innocent board members who actually terminated the bad actor when his conduct was discovered. Here, Petitioner's own allegations in this case demonstrate that ETS was an active participant in all stages of the alleged Ponzi scheme.

C. There Is No Split in the Federal Circuits on the Application of *In Pari Delicto* to Bar a Federal RICO Claim.

Petitioner claims that "numerous" federal courts have held that *in pari delicto* is not applicable to RICO claims in any case or context. Petitioner's Brief at 16. However, Petitioner cites to only two District Court cases for this sweeping proposition: *Harper v. American Tel. and Tel. Co.*, 54 F. Supp. 2d 1371, 1380 (S.D. Ga. 1999), and *In re National Mtg. Equity Corp. Mtg. Pool Certificates Sec. Litig.*, 636 F. Supp. 1138 (C.D. Cal. 1986). Both of these cases are factually and legally distinguishable. Unlike Petitioner's case, which is brought on behalf of a debtor, *Harper*[7] involved a lawsuit brought directly by individuals who alleged that AT&T had defrauded them, resulting in violations of the Federal RICO Act. There was no bankruptcy trustee involved and, more importantly, no allegations of the plaintiffs' involvement in the allegedly fraudulent scheme. *In re National Mortgage*, which was decided by the Central District of California in 1986, did not involve a bankruptcy trustee or allegations that demonstrated that the plaintiffs were active participants in the underlying securities violations.[8] Moreover, in *Williams*

7. In *Harper*, the court granted summary judgment to defendant AT&T based on the plaintiff's failure to satisfy the elements of a Federal RICO claim. In dicta, the court addressed the application of a state law defense based on the voluntary payment doctrine (O.C.G.A. 13-1-13) and briefly analogized it to the defense of *in pari delicto*.

8. The *In re National Mortgage* court specifically noted that the "*extent and nature of the Bank's participation in the alleged RICO violations may be relevant, assuming it turns out that*

(Cont'd)

v. California 1st Bank, 859 F.2d 664 (9th Cir. 1988), the Ninth Circuit reversed a California court's denial of a motion to dismiss a trustee's claims against a third party arising from the third party's alleged participation in a Ponzi scheme. Relying on this Court's decision in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), the Ninth Circuit held that the Trustee lacked authority to bring suit on the claims. *Williams*, 859 F.2d at 667 ("Indeed, since [the defendant] and [the debtor] may well stand *in pari delicto*, the bank likely will be able to subrogate itself to the investors' position to pursue their claims against the debtor's estate to recoup any judgments rendered in this action"). Thus, Petitioner has no support for his claims that there is a "split" in authority regarding the applicability of *in pari delicto* to a RICO case.

Petitioner argues half-heartedly that this Court's decisions in *Perma Life Mufflers, Inc. v. Int'l*, 392 U.S. 134,

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(Cont'd)

defendants are entitled to raise defense of 'complete involvement.'" 636 F. Supp at 1156 n.25 *citing THI-Hawaii, Inc. v. First Commerce Fin. Corp.*, 627 F.2d 991, 995 (9th Cir. 1980) (emphasis added). The court continued that, "Whether, if defendants can show that the Bank's conduct amounted to 'truly complete involvement and participation' in the alleged RICO violations, the Bank's treble damage claim should be barred, is an issue not presently before the Court." Here, Petitioner's own allegations demonstrate ETS's "complete involvement." As the Eleventh Circuit noted, the only mildly relevant statement from *In re National Mortgage* was a comment that the reasoning of this Court in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968) regarding the punitive and deterrent aspects of antitrust treble damages is "equally applicable to RICO treble damage actions." Petitioner's Appendix at 28a. However, this does not speak to the issue of whether a trustee can assert such claims when the debtor itself was "completely involved" in the alleged conduct.

140 (1968), and *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310-311 (1985), suggest that *in pari delicto* should not be applied in the Federal RICO context. First, these cases were not decided in the context of Federal RICO. Instead, they dealt with antitrust and securities issues, respectively. More importantly, both dealt with only passive participation in the underlying federal law violations. As the Eleventh Circuit noted in its Opinion, *Perma Life Mufflers*, which involved franchisees who were passively involved in alleged antitrust violations, "explicitly left open the question of whether complete involvement in an antitrust violation, 'wholly apart from the idea of *in pari delicto*,' would bar a plaintiff from bringing an antitrust claim." Petitioner's Appendix at 24a, *citing Perma Life Mufflers*, 392 U.S. at 140. *Bateman Eichler*, which involved tippees who were not active participants in the federal securities law violations, also noted that "where a plaintiff truly bore at least substantially equal responsibility for the violation, a defense based on such fault . . . *should be recognized.*" *Id.* at 308-309 (emphasis added). Thus, these opinions actually support Respondents' position that an active participant with complete involvement like ETS is barred from asserting these claims by *in pari delicto*. Because Petitioner can only bring the claims that ETS could have asserted, he is also barred. Thus, the opinions of this Court cited by Petitioner are actually in harmony, not conflict, with the opinions of the six Courts of Appeals that have already uniformly addressed these issues.

D. There Is No Support for Petitioner's Argument That Courts Should Ignore the Pre-Petition Conduct of the Debtor and Allow a Trustee to Bring Claims That the Debtor Could Not Have Brought.

In his Petition, Petitioner tries to shift the focus away from the actual pre-petition conduct of ETS alleged in his Third Amended Complaint. Rather, he wants to focus on his own post-petition appointment as trustee of the litigation trust. As "support" for his argument that a court should ignore the debtor's pre-petition participation in wrongful conduct, Petitioner erroneously cites this Court's decisions in *Segal v. Rochelle*, 382 U.S. 375 (1966), and *Kokoszka v. Belford*, 417 U.S. 642 (1974). Petitioner cites these cases as examples of cases where he claims that this Court looked at "bankruptcy policy and purposes" to determine what constitutes "property of the estate." Petitioner's Petition at 20. However, both of these cases are more properly read for the conclusion that, in order to determine whether a tax refund that was earned pre-petition but paid post-petition becomes property of the estate, the Court must look at pre-petition events to determine whether the amounts were "sufficiently rooted" in the pre-bankruptcy past and so little entangled with the debtor's ability to make an unencumbered fresh start that it should be regarded as "property." They do not address whether it is appropriate to ignore the pre-petition conduct that demonstrates that the debtor would have been barred from bringing the claims against the Respondents.

In *Segal*, this Court held that a business generated loss carry-back tax refund, which was based on pre-bankruptcy losses but was received after bankruptcy, should pass to the trustee under § 70(a)(5) property. *See Segal*, 382 U.S. at 380.

In *Kokoszka*, the Court affirmed an order directing the turnover of a debtor's income tax refund related to wages withheld before the debtor filed for bankruptcy. *See Kokoszka*, 417 U.S. at 648. Contrary to Petitioner's argument, these decisions highlighted the importance of focusing on what happened pre-petition in order to determine whether these specific assets came into the estate or not. These cases did not have anything to do with whether a trustee can assert a claim that the debtor could not have asserted because of the debtor's pre-petition involvement in the allegedly actionable conduct.

Petitioner's characterization of these cases ignores the forest for the trees and Petitioner fails to realize that these cases actually favor Respondents' position. Clearly, the focus in *Segal* and *Kokoszka* was on what the debtor did (or did not do) prior to the petition (*e.g.*, earning the wages and filing the taxes giving rise to the refund, etc.). Petitioner, on the other hand, wants the Court to ignore what ETS did pre-petition and allow him to bring a claim that, based on the pre-petition conduct of ETS, could not have been brought by ETS as of the commencement of its bankruptcy case. This position cannot be reconciled with the underlying policy behind, or clear language found in, the Bankruptcy Code, which fixes the petition date as the time when claims and defenses must be evaluated. As such, Petitioner's request for this Court to make a "definitive ruling" in this area, with no actual conflict or controversy in the law, should be rejected.

II. There Is an Additional and Alternative Basis for Affirming the Eleventh Circuit's Decision.

Although Petitioner has invited this Court to address a "split" in authority that does not exist, it is noteworthy that there is an additional and alternative basis for affirming the Eleventh Circuit's decision to affirm the dismissal of the RICO claims (Count XI, XII, and XIII) even if *in pari delicto* were not applicable. Section 107 of the Private Securities Litigation Reform Act ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737 (1995), amended the federal RICO Act to provide that "*no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962.*" 18 U.S.C. § 1964(c) (emphasis added).

Numerous courts have relied upon this clear statutory language to bar RICO claims arising from conduct that could have been pursued as securities claims. *See, e.g., Bald Eagle Area School Dist. v. Keystone Financial, Inc.*, 189 F.3d 321, 327-29 (3d Cir. 1999) (affirming dismissal of RICO claims brought by investors in a Ponzi scheme against the custodians of the accounts in which the Ponzi scheme investments were held); *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 284 F. Supp. 2d 511, 620 (S.D. Tex. 2003) (holding that "[t]he RICO Amendment bars claims based on conduct that could be actionable under the securities laws even when the plaintiff, himself, cannot bring a cause of action under the securities laws."); *Howard v. America Online, Inc.*, 208 F.3d 741, 749-50 (9th Cir. 2000), *cert. denied*, 531 U.S. 828 (2000) (affirming dismissal of RICO claims based on conduct actionable as securities fraud even though plaintiffs [AOL subscribers] lacked standing to bring

such securities fraud claims themselves); *Florida Evergreen Foliage v. E. I. DuPont De Nemours & Co.*, 165 F. Supp. 2d 1345, 1357 (S.D. Fla. 2001) (following *Howard*), *aff'd on other grounds sub nom*; *Green Leaf Nursery v. E. I. DuPont De Nemours & Co.*, 341 F.3d 1292 (11th Cir. 2003); *Fezzani v. Bear, Stearns & Co., Inc.*, 2005 WL 500377, *4-6 (S.D.N.Y. Mar. 2, 2005) (RICO claim barred even if particular defendant did not engage in actionable securities fraud).

In accordance with the plain language of Section 107 of the PSLRA, no one, not even the Petitioner, can rely upon conduct that would have been actionable as securities fraud to establish a RICO violation. This is precisely what the Petitioner is trying to do in this case. It is not disputed that numerous investors in ETS filed their own individual and putative class actions alleging securities fraud arising from their ETS investments.[9] In *SEC v. Edwards*, 540 U.S. 389 (2004), this Court even issued an opinion relating to the payphone investments at issue in this Petition and held that investment contracts promising a fixed rate of return (like the payphone investments offered by ETS) can be securities. In light of the fact that the investors/creditors of ETS could have (and have) asserted securities claims based on these same facts, Section 107 of the PSLRA provides an additional and alternative basis for affirming the dismissal of Petitioner's RICO claims.

9. The fact that the investors themselves have already asserted claims against, *inter alia*, the Respondents, for securities violations demonstrates that Petitioner's claim that he is representing those who cannot represent themselves is unfounded.

CONCLUSION

Petitioner has not established any compelling reason for this Court to grant the Petition. Therefore, Respondents respectfully request that the Petition be denied.

Respectfully submitted,

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